S. HRG. 101-60

IRS MANAGEMENT QUALITY IMPROVEMENT PROGRAMS AND TAXPAYER SERVICES

HEARING

BEFORE THE

SUBCOMMITTEE ON PRIVATE RETIREMENT PLANS AND OVERSIGHT OF THE INTERNAL REVENUE SERVICE

OF THE

COMMITTEE ON FINANCE UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

FEBRUARY 22, 1989

Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

98-371 WASHINGTON : 1989

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

5361-35

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IRS MANAGEMENT QUALITY IMPROVEMENT PROGRAMS AND TAXPAYER SERVICES

WEDNESDAY, FEBRUARY 22, 1989

U.S. SENATE,
SUBCOMMITTEE ON PRIVATE RETIREMENT PLANS AND
OVERSIGHT OF THE INTERNAL REVENUE SERVICE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 9:30 a.m., in room SD-215, Dirksen Senate Office Building, Hon. David H. Pryor (chairman of the subcommittee) presiding.

Also present: Senators Bradley and Heinz.

[The press release announcing the hearing follows:]

[Press Release No. H-6, January 31, 1989]

FINANCE SUBCOMMITTEE TO REVIEW IRS MANAGEMENT QUALITY IMPROVEMENT PROGRAMS AND TAXPAYER SERVICES

WASHINGTON, DC—Senator David Pryor, (D., Arkansas), Chairman of the Senate Finance Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service, announced Monday that the Subccmmittee will hold a hearing to review the General Accounting Office report, *Managing IRS: Actions Needed to Assure Quality Service in the Future.* Additionally, the Subcommittee will review the quality of taxpayer services and IRS quality initiatives.

The hearing is scheduled for *Wednesday, February 22, 1989 at 9:30 a.m.* in Room SD-215 of the Senate Dirksen Office Building.

"The Internal Revenue Service will soon collect $1 trillion in taxes from well over 100 million taxpayers," said Senator Pryor. "Congress needs to keep a careful eye on the agency to ensure that it collects those taxes in a fair and efficient manner."

Pryor said, "The key to our voluntary tax system is maintaining the public's confidence in the IRS. The GAO has brought to our attention a number of problems which if not corrected in the near future could seriously erode that confidence."

OPENING STATEMENT OF HON. DAVID PRYOR, A U.S. SENATOR FROM ARKANSAS

Senator PRYOR. Ladies and gentlemen, this Senate meeting will come to order. This morning I would like to extend a particular welcome to Commissioner Larry Gibbs on his last hearing before Congress as Commissioner of Revenue. It is very hard to believe that it has been over 2 years since you first appeared before this subcommittee. We have not always been on the same side of the issues, but we have always been committed to the same goal—the betterment of the Internal Revenue Service and its relationship with the taxpayer.

A number of times you have asked me to speak to Internal Revenue Service employees from around the country. I was struck by one fact. Whenever I mentioned the name Larry Gibbs, those em-

ployees cheered. Mr. Commissioner, your employees cheered because you have restored their pride in working for an essential agency and a critical function of our free democratic process. I believe this is one of the greatest tributes to your work as the Commissioner of the IRS. As you once again become a private citizen, I hope that we can continue to work together to improve the Internal Revenue Service.

Today, we are here to discuss the IRS's commitment to quality. The General Accounting Office's report, "Managing IRS: Actions Needed to Assure Quality Service in the Future," I say and I hate to say, it paints a very bleak picture of the of the future of the Internal Revenue Service. The picture is of an upcoming train wreck.

Sometime during the mid-1990's, the present computer system, according to GAO, will no longer be able to handle its workload. However, the GAO report also tells us that the IRS is not taking the necessary steps to prevent this system from crashing. The report shows that progress has been slow due to the lack of (1) effective management direction and commitment, (2) weakness of IRS planning, and (3) technology procurement problems. Consequently, the time frame for full implementation of a new system able to handle the present workload has slipped from 1995 to 1998. Since 1982, the IRS has pursued four different developmental approaches for the proposed modernization project. Despite five years of work at a cost of over $70 million, the GAO now believes that the IRS is essentially still at square one. Failure to prepare for the crunch that is to come will result in a disaster hundreds of times worse than the Philadelphia episode of 1985.

The modernization program will require a large investment of public funds—as much as $11 billion according to the IRS's own business plan. The GAO report suggests that the IRS's ability to manage those funds are questionable. The report states, and I quote, "IRS's ability to satisfy its financial responsibilities and meet taxpayer expectations has been undermined by accounting processes with weak internal controls and old systems that produce inaccurate and untimely information." In other words, the agency that requires each of us to keep perfect records on our finances cannot keep track of its own finances.

For example, the GAO report cites the acquisition and implementation of the Realtime Input System or "RIS." When the IRS canceled this project in March 1986, its implementation schedule had slipped 18 months and its cost estimate had grown 14 times from the original $8.5 million to around $120 million. The IRS could not give to the General Accounting Office the actual amount spent on this project before its cancellation, because the IRS did not even have a system in place to keep track of the project's cost. After spending millions of dollars, the IRS itself admitted it had never established the system's "feasibility, desirability, and cost effectiveness."

In another example, an internal audit report found that the IRS purchased 2,000 more computer terminals than the IRS itself admitted it needed. On top of this, IRS Computer Services had requested funds for an additional 5,000 terminals. Total cost of these unneeded terminals: $25 million. To get an idea of the magnitude of this purchase, the internal audit report states that "this quanti-

ty would cover the replacement of all old terminals plus a 72 percent network expansion." And, despite terminal utilization studies which showed that 7,000 terminals were not needed, the IRS Computer Services ordered the terminals anyway. The report concludes that the weaknesses in the IRS's accounting system increases the potential for employee fraud.

The IRS management review study raises serious doubts, Mr. Commissioner, about the IRS's ability to manage the large amount of appropriated funds needed to implement a far-reaching computer modernization.

In addition to these problems, I would like the subcommittee today to discuss various long-term problems with the IRS's handling of taxpayer correspondence and its managing of the Problem Resolution Program. Over the years, a number of reports, both within and without the Internal Revenue Service, have pointed out problems with the IRS's handling of taxpayer correspondence at its service centers. A GAO report issued last year reveals that out of 12 million taxpayer correspondence cases closed in fiscal year 1987, the Internal Revenue Service had made critical errors in over 31 percent of those cases.

To understand the significance of this finding, Mr. Commissioner, it is important to picture what is actually occurring in this area. In many cases, somewhere in the bowels of the IRS Service Center bureaucracy someone, or some computer, has "turned on the deficiency notice machine." This means that a taxpayer who has faithfully responded to a request by the Internal Revenue Service simply vanishes into a bureaucratic black hole, because 31 percent of the time, IRS personnel fail to "turn off" the deficiency notice machine. The result is that the IRS issues additional erroneous notices and possibly even initiates wrongful collection actions. The problem certainly increases taxpayer frustration and it increases, ultimately, the IRS workload. Many of the taxpayer horror stories brought out in the past 2 years during debate on the Taxpayers' Bill of Rights can be traced directly to this particular correspondence problem between the taxpayer and the tax collector.

Mr. Commissioner, I would like to tell you, if I might—and I am not trying to publicize any particular private industry or business—recently I had the opportunity on a very early morning to visit in Washington, DC a Federal Express center. As the daily packages arrived for delivery at this center early in the morning, the Federal Express employees checked each one in their central computer system to insure proper delivery. At any time, a customer of this company can call a number to check on the location of his or her package, in fact, they can even tell you who signed for that particular package. Within half an hour, a Federal Express employee will call that customer back and tell him or her the exact precise location of that particular letter or package—whether it is on the plane or the truck or in a center, or whether it is scheduled to arrive on time or to be a little late. I asked one of the employees what happens if they ever lose a letter or ever misplace a package. The employee became very grave and he said, and I quote, "the person last responsible for the package or letter will expect a phone call from the president of Federal Express. They have a

little talk about that lost package, and that is usually the last time a package is ever lost on that particular employee's watch."

Mr. Commissioner, I want to ask, I guess, why we cannot have that sort of accountability and eye for quality at the Internal Revenue Service. I think we can. The question before us today is what sort of an IRS will we have by the end of the 1990's—whether we will have a Federal Express, a Studebaker, or maybe even a Kaiser-Frazier. No less than the solvency of the U.S. Government is at stake.

The subcommittee will concentrate on five areas: (1) Computer systems modernization; (2) Problems with IRS financial accounting systems, (3) Taxpayer correspondence problems at the Service Centers, and (4) The "quality" of the service initiatives at the Internal Revenue Service, and finally (5) The "problems" with the Problems Resolution Program.

Mr. Commissioner, at this time and I say to our friend, Mr. Dodaro from the General Accounting Office, I am going to yield to my friend and colleague, Senator Heinz of Pennsylvania.

[The prepared statement of Senator Pryor appears in the appendix.]

OPENING STATEMENT OF THE HON. JOHN HEINZ, A U.S. SENATOR FROM PENNSYLVANIA

Senator Heinz. Mr. Chairman, thank you.

First, Mr. Chairman, I would like to commend you on having this hearing. It is a timely hearing. This is the last occasion on which Larry Gibbs will be before us as IRS Commissioner. I think he has served in that position with great distinction.

What is, I think, extremely unfortunate is that it is now February 22 and the Administration has failed as yet to nominate somebody for Larry Gibb's position. If there is one thing that I agree with in the comments that you have made, it is the IRS, in spite of enormous improvements made by Larry Gibbs, has a tremendous challenge ahead. And the sooner that there is someone sitting in this room taking note of the interests of this committee and of the findings in the joint—and I emphasize joint—IRS/GAO study that has been the subject of the chairman's comments, and appropriately so, the sooner the IRS will be in shape to really tackle the very challenging and important problems that affect not only them internally but most importantly the millions of taxpayers across this country.

I noted, as has the chairman, that this is the last time that Commissioner Larry Gibbs will testify before this committee. Let me say, Larry, that I do not want to miss this opportunity to congratulate you on a job well done. You have been a professional. You have been an achiever. You have been responsive to the legitimate concerns of the taxpayer. And if it is not stretching a point too far for somebody who is the nation's chief tax collector, in my judgment, you thereby have been a friend of the taxpayer as well. Something not easy for the head of the IRS to claim.

I might say, Mr. chairman, you mentioned the Philadelphia story of 1985. I refer to it as the Philadelphia nightmare. That was something that we suffered before Larry Gibbs came on the scene, but it

represented, as you pointed out, the virtual collapse of an entire IRS Regional Processing Center. When Larry Gibbs accepted the job as IRS Commissioner, there was an even greater potential for disaster than that which struck in Philadelphia in 1985. That was the Tax Reform Act of 1986.

Tax Reform changed over 2,000 subsections of the IRS Code. Those sweeping changes required very careful IRS preparation for the 1988 tax filing season, including extensive education of the taxpaying public, not to mention of the tax processing bureaucracy. Larry Gibbs had barely 1 year to get prepared.

As testimony to his affective stewardship, the GAO issued a report in November 1988 entitled—and I brought a copy of the report— "The Effective Implementation of the Tax Reform Act Led to Uneventful 1988 Filing Season." I suppose one of the things that never gets covered in this town is satisfying news. The word "uneventful filing season" probably caused this report to be just dropped in the nearest round file. Yet, to have an uneventful filing season after what we had in 1985 and 1986 happens to, in my judgment, be an absolutely remarkable if not spectacular accomplishment. I suppose this report might have been entitled, "The Bomb That Didn't Go Off."

I would like to read the conclusion of this report. It says that, "The changes and uncertainties caused by the Tax Reform Act of 1986 increased the potential for significant problems during the 1986 filing season." What an understatement that was. "In terms of the IRS's ability to handle the increased workload in a timely manner, that potential went unrealized. Returns were issued. Telephones were answered. Computers ran relatively trouble free," the report says.

I think, Mr. Chairman, that report is a great testimony to Larry Gibbs' stewardship. He has left a very clear and good record of accomplishment. Not to say that there are not challenges ahead, but I do want—with reference to the GAO report of October 14, 1988 from which you quoted liberally—to make just two or three points.

The first, as I alluded to earlier, is that this report, although it is on good old-fashioned GAO letterhead which we really appreciate and it is something of a good housekeeping seal of approval up here on the Hill since you are our creation, it represents something I myself have never seen happen. It was a joint project between the IRS and the GAO. In effect what the IRS said, and it was Larry Gibbs who said it, "We want the very best people in this country. We want the GAO, who are the best auditors in the country, to work with us and tell us how we can make the IRS world class and beat even Federal Express."

That is quite a change from the often confrontational relationship, and Mr. Dodaro knows what I am talking about, that sometimes exist between a Federal Executive Branch Agency and the GAO. Larry, if I am right that this is the first time, and I think it is certainly the first time that anything of this great a significance, it is a very good model for many other agencies – the Defense Department comes to mind as somebody who will benefit from working with the, if you will, the consulting arm of Congress, that the GAO represents. So I commend you for that.

Second, I notice that my good friend the chairman quoted from some of the more critical problems, not to say sensational text, in the GAO report. I think that it needs to be said that when you look at the results in brief, which is even briefer than the summary of the principal findings, and the GAO enumerates the IRS's most pressing challenges, five in number, the concluding paragraph ought to be read into the record.

Namely that, "The IRS has taken several recent actions to help address these challenges. It has reorganized its top management structure to improve accountability and strengthen communication. It has improved its management decision-making by setting up a strategic management system and initiated efforts to improve the quality of its services. These actions provide a good beginning but a concerted effort on many fronts as required over the long term if the IRS is to further improve its operations."

If you go through the report, it is clear that some very significant things with specificity have been achieved. As the GAO reports, and I quote, "Historically modernization proposals have been rejected by the Treasury Department in part because they were not clearly tied to IRS mission." Which is one way of saying that over the last 6 years, from 1982 to 1986, it was very hard to get anything done because OMB and therefore the budgeters would not go along with it.

In March 1988, IRS issued a basic management plan for the redesign—that is Larry Gibbs' plan. Treasury officials approved the overall direction set forth in this plan and that was the basis for the enormous amount of progress that has been initiated.

Mr. Chairman, I do not want you to think I do not agree with you that the challenges ahead are very real, very major, and that is why I made the comment I did at the outset that it is critical that the Bush Administration name the next IRS Commissioner at once. Every week lost is a week of potential confusion at tax filing time. We do not know whether that confusion will hit us in 1991, 1992 or 1993. But there are many problems, many of them not of the IRS making, that need to be address and that can only be addressed with strong leadership at the Internal Revenue Service.

I could not help but think, Mr. Chairman, when you mentioned Federal Express that Larry Gibbs has accomplished what he has, and it is significant, without many major disadvantages that do not so burden a Federal Express. He has salary caps and as the GAO points out, half of his senior managers are going to be eligible for retirement very quickly and 60 percent of them—unless I forget my numbers—have said that they are going to opt for retirement within a year of their becoming eligible. When you lose the best of your top management, that is a problem.

Federal Express does not have that problem. Federal Express does not have OMB to contend with. They can also go to the market for additional financing when they need capital equipment and computers. To the best of my knowledge, Larry Gibbs has not been able to figure out a way around OMB. Federal Express, it is true, has competition. And unless they have become much more bureaucratized than I suspect, most people who work at Federal Express have not been hired for life as some people accuse those entering into the Federal civil service.

I would say that, not to be critical of anybody, but to indicate that in spite of those and many other disadvantages not to mention the fact that Congress does occasionally make a few changes in the law with which the IRS has to cope—and we do not do that for Federal Express as yet—Larry has done a superb job.

Larry, I commend you. I thank you. As I say, you have been not only a friend of this committee but a friend of the taxpayer as well. That is not an oxymoron by any means.

Senator PRYOR. Thank you, Senator Heinz.

Our study indicates in the past, Mr. Gibbs, that the average tenure for an IRS Commissioner is about 36 months. When you leave, how long will you have been with the IRS as the Commissioner?

Commissioner Gibbs. I joined the Internal Revenue Service in August 1986. So it will be a little over 2½ years.

Senator PRYOR. Mr. Gibbs, you have a statement and I have read this statement. We are going to place your entire statement in the record.

We would like to give you sufficient time to give this statement. If we could, I would like to limit it possibly to no more than 10 to 15 minutes, a summary of that statement. We look forward to it and after you finish we will call on the General Accounting Office.

Thank you.

STATEMENT OF HON. LAWRENCE B. GIBBS, COMMISSIONER, INTERNAL REVENUE SERVICE, ACCOMPANIED BY JOHN WEDICK, DEPUTY COMMISSIONER, PLANNING AND RESOURCES, CHARLY BRENNAN, DEPUTY COMMISSIONER OF OPERATIONS, MIKE MURPHY, SENIOR DEPUTY COMMISSIONER OF OPERATIONS, DAMON HOLMES, TAXPAYER OMBUDSMAN, AND AL KOLAK, ASSISTANT TO THE COMMISSIONER FOR QUALITY, INTERNAL REVENUE SERVICE

Commissioner Gibbs. Thank you, Mr. Chairman. I would like to thank you and also Senator Heinz for your generous comments with respect to my tenure.

I would also like to introduce the other representatives of the Internal Revenue Service who are here with me today. To my right is Mike Murphy, our Senior Deputy Commissioner. To Mike's right is Charly Brennan, who is our Deputy Commissioner for Operations. And to Charly's right is John Wedick, who is our Deputy Commissioner for Planning and Resources.

Senator PRYOR. We welcome these witnesses today.

Commissioner GIBBS. Thank you, Mr. Chairman.

Also behind me is Damon Holmes, our Taxpayer Ombudsman; and Al Kolak, who is our recently appointed Assistant to the Commissioner for Quality. Several IRS Assistant Commissioners are here who will be happy to respond with respect to any questions you have that involve their particular areas.

I do not plan to follow exactly my formal written statement, and I will try to keep my comments within 10 to 15 minutes as you requested.

I would like to begin with a quote from the General Accounting Office report, "Managing IRS: Actions Needed to Assure Quality

Service in the Future." The report literally begins on the second page by saying, "Given its vast and complex responsibilities, IRS generally has done a capable job in accomplishing its mission."

Senator Heinz pointed out, this was and is a joint report, one that the Internal Revenue Service and the General Accounting Office undertook jointly. It was intended by us and by them to set forth the challenges that our organization faces as we go into the last decade of this century. It was done very specifically to try to set forth the issues and the concerns that we as an organization will face.

I would like to publicly thank the GAO, the Controller General, Mr. Bowsher, and particularly the gentleman seated to my left, Gene Dodaro, who was the head of the group that worked with the Internal Revenue Service in putting the report together. I think it is a good report. We jointly cooperated in preparing the report. We agree with the recommendations, and many of the recommendations have already been accomplished. All are recommendations with which we agree.

I would also like to state as I leave the Internal Revenue Service that I agree with the overall assessment of the General Accounting Office that I quoted a minute ago. I think the Internal Revenue Service is doing a good job. Can it be done better? Are there criticisms that can be made? Are there issues and concerns? Of course. But in terms of the overall thrust of the report and my evaluation of the organization as I leave, I will say that I think the Internal Revenue Service has made a good start on the issues that face us as an organization, and I think IRS is generally doing a good job.

Why? I think there are some specific reasons, things that have come about very consciously in the last several years—not just the last several years that I have been here, but the last several years in terms of the decade of the 1980's. First and foremost, I think the organization consciously understands its mission—what it is about, what its purpose is. I think that is important. After substantial discussion, we have developed a statement of what we feel our mission is—namely, to collect the proper amount of revenue, to minimize the cost in doing so, and to maximize the public's confidence in our efficiency and integrity and fairness. I think that is a good summary in terms of what we are about and I think it is something that our organization understands.

We have in the last several years developed an overall approach to how we plan to address the accomplishment of this mission in the foreseeable future. We have done that in the context of what we call a Strategic Business Plan; that is, thinking about the issues that are going to confront our organization as outlined by GAO and the Internal Revenue Service in the next 5 to 10 years, and then thinking strategically about how we are going to get from here to there if we are to meet those challenges.

The strategic business planning process has been going on for over a year now in terms of a formal process. Within the last several weeks, the leaders of the Internal Revenue Service, whom we have come to call the Board of Directors, met to develop a specific strategic plan to deal with what confronts us into the mid-1990's. We will shortly have that available to share with you. It sets specific objectives. It outlines specific strategies for accomplishing

those objectives. And those objectives and strategies will drive the specific action items that will show up in our functional annual business plans over the next several years.

The business plan is now driving the budget. For years, like many agencies, the budget drove us. Now, the business plan drives our budget in terms of prioritizing where we are going to be putting our money in order to accomplish the things that we have outlined, and as a way to address these and other issues that are going to face us.

We plan to follow that with a specific business review, an annual review, where we will actually be reviewing the functions within our organization to determine how are they contributing to the accomplishment of those specific action items, strategies and objectives in fulfillment of the plan. We have this set up. We are piloting it at the present time. After we do that, we feel that we will be able to set standards and measurements for the actual accomplishments of the strategies and objectives in the business plan.

Ultimately, we plan to do the same type of thing in terms of standards and measurements for each of the individuals in our organization, so that each of the individuals can begin to identify how his or her job fits in with our overall strategies and objectives in terms of how we are going to accomplish our mission.

In short, what I am trying to say—what I am trying to outline—are the reasons why I feel the organization at the present time knows where it is going. But I would also say that the Internal Revenue Service knows how we are going to get there from here, and I am not talking now just about the Strategic Business Plan. We have our leadership in place as a result of the 1987 reorganization.

Mr. Murphy is the Senior Deputy Commissioner and is the Chief Operating Officer of our organization. Mr. Brennan and Mr. Wedick are the two deputies that have line authority over the other activities in the Internal Revenue Service. Our Regional Commissioners and our Assistant Commissioners in charge of our functional operations report to Mr. Brennan. Our human resources, our budget resources, and our information resources report to Mr. Wedick. We have an organizational approach that I think will permit, the clear delegation of authority and understanding of authority in order to be able to meet the objectives that we set for ourselves.

We also understand the importance of information technology—our computers, our hardware, and our software. Substantially all of our functions are either automated or in the process of automating. We are also in the process of redesigning our information systems and that, as you point out, will last into the mid- and late-1990's. This is a major undertaking. Within the last several years we do have a plan and approach, a consistent plan and approach. It has been approved by Treasury and it has been approved by the Office of Management and Budget in terms of how we are going to do that.

Over the last 5 years, the Internal Revenue Service has participated with a number of private sector organizations in a research consortium led by the Massachusetts Institute of Technology. It is called "Management in the '90s," and it includes private compa-

nies such as American Express, Eastman Kodak, MCI, British Petroleum, the U.S. Army, and a number of other major players in the information technology area. What we have been taking a look at is how information technology can be used in the decade of the 1990's to fulfill the objectives of these organizations.

Recently, the chief executive officers of these organizations, including myself, met in Boston, MA to discuss the 5-year project. What we did was analyze how information technology facilitates the changes that are going to be made and that must be made in each of our organizations in order to meet the challenges that each of those organizations faces. I think that is simply one indication of an effort where we are going outside our organization to take a look at what others are doing and how they are using their information technology to address the problems that they foresee, the issues that they have. We are doing the same thing.

The interesting thing about the meeting with these CEO's from these top companies was that they said, as important as information technology is, it is simply a facilitator, it is an enabler, but it does not drive change. It does not cause the changes to be made that really are necessary to meet the challenges that each of us foresees for our organizations. What those CEO's said is what drives change increasingly in their organizations is the quality process. It was interesting to me that we took several hours to discuss how quality is really driving change, using information technology as a facilitator; but it is the quality process that they and I frankly believe is going to be the driver for the changes that need to take place.

Our quality process is in place. We began top down. That is to say, we began by training our top executives with respect to the quality process. We have now trained 10,000 of our managers and we have now completed 4 hours of training for each of the employees in terms of exposing them to the quality concepts and the approach that we are going to be using.

We also have the quality infrastructure in place. We have quality councils in the national office, in the regional offices, in the district offices, and in the service centers. These are councils of the employees that basically identify and target, problem areas and then assign quality improvement project teams to address the issues and problems that are identified, using the training that has been given to try to address and solve the various problems. This is only one aspect of the quality process.

We have used Dr. Juran as out consultant. He recommended to us that we start with this type of identification and problem solving in the quality area. But it is only one facet of the quality process.

We are also now beginning to move into the quality planning process, where we actually will be redesigning our computer systems, redesigning the rules, regulations, the things—the barriers—that get in the way of delivering quality services and quality products.

We have recently named Al Kolak as the Assistant to the Commissioner for Quality. We now have someone whose full-time job will be quality at the Internal Revenue Service, but we have done this in such a way that we are not going to functionalize quality. It

is not going to be the responsibility of Al Kolak, or a function; it is going to be the responsibility of every single employee in the Internal Revenue Service. That is what has worked in the private sector and that is what we are going to do.

Finally, and most importantly I think, we have a joint process under a mutual agreement with the National Treasury Employees Union that will be driving this whole process. So we have gone top down and bottom up, if you will, in terms of having a joint agreement with our union and with our employees to bring quality to the Internal Revenue Service.

I would like to give some examples of the types of quality services that we are providing and I would like to tell you just a little bit about what we are doing.

The quality process is important, in my opinion, because in the final analysis it is customer oriented. We do not determine our quality, our customers do. That is something that is a change for our organization and for many organizations in the private sector, to recognize that it is the customer out there who is setting the demand for quality and in the final analysis will be the arbiter of quality.

I would also like to emphasize that, as the private sector has told us, quality is a process. It is not something you do this year. It is not something that will be completed in five years. It is an ongoing process. Can you find examples where quality has broken down? Can you show examples where we are not fulfilling the customers' desires? Absolutely, of course. We recognize that. That is the challenge that we face.

I would like to specifically mention two areas where we are beginning to meet these challenges. One is the taxpayer correspondence area that you mentioned in your opening statement. I testified last summer with respect to the GAO report that was published then, entitled, "IRS Service Centers Need to Improve the Handling of Taxpayer Correspondence." We agree. The GAO in that report made three recommendations. In our testimony later, we will be happy to outline for you how we have attempted to start and have done very specific things to accomplish each of the three recommendations to improve taxpayer correspondence.

By the way, those specific changes that we are making grew out of a quality improvement project that was begun by IRS about 2 or 3 years ago.

You mentioned taxpayer service. Again, we have a GAO report on the taxpayer service results for last year. We also have, for this year, a new quality measurement system in place—the Integrated Test Call Survey System. It is something that we think, working jointly with GAO, we can use to measure what our quality is.

Frankly, Mr. Chairman, it is a little painful to get out and admit where your challenges are, where you can do a better job, and to do it week by week. But, Mr. Chairman, that is what we are doing. We are backing it up with something this year that goes just beyond the measurement process and that is with our regional diagnostic centers. There, we actually diagnose on a region-by-region basis where we are falling short and then take the steps following along behind the measurement process for how we can improve.

We also are developing an Automated Taxpayer Service System. We are piloting it in Dallas, and I was down there this year to see it. We believe that as we perfect it, it will be something that will help our taxpayer assisters on the telephone improve the accuracy of the advice that they are giving.

And finally, I would mention our Problem Resolution Program. Again, a General Account Office report outlined places where we needed to improve, but the thrust of that report was to state, and I quote, "The Problem Resolution Program has been successful in achieving its taxpayer assistance objectives and in helping to improve IRS' image in the eyes of taxpayers." And again, GAO found that taxpayers were generally satisfied with the assistance they received. Overall, this is a plus for the program.

In our testimony, we discuss how we have approached and what we have done with respect to the implementation of each one of those four recommendations.

Mr. Chairman, we are not there yet. I do not suggest that we are. But I do suggest, Mr. Chairman, that we have made a good start and I would like to suggest that you can help us in three areas: (1) helping us with our budget resources to insure that we have the resources to do what we want to do; (2) insuring that we are as competitive with our pay to our senior executives, middle-level folks, and folks that are just coming in the organization, as perhaps Federal Express is with their executives and their employees; and (3) finally, you can help us a great deal in terms of minimizing the number of tax law changes that drive the ever increasing workload and the change and complexity with which we deal on a daily basis.

Mr. Chairman, let me close by saying that you have pointed out that I will be leaving in 10 short days. This has been a difficult decision. I have enjoyed by tenure with the Internal Revenue Service. It has been a pleasure and a privilege to serve as Commissioner of the Internal Revenue Service and to work with the many dedicated individuals throughout the Internal Revenue Service. I have appreciated your assistance. I have appreciated your support and I have appreciated your warm and constructive criticism. I mean that sincerely.

We have disagreed, as you point out, from time to time on specific things. But I think we have always agreed about the importance of improving the way the Internal Revenue Service accomplishes its mission and the importance of the role the Internal Revenue Service plays within government.

Although I am leaving the Internal Revenue Service, I promise you I will not lose my interest in tax administration. Therefore, I look forward to helping you, at your request, and certainly the Internal Revenue Service, at its request, to address the issues that we are going to be discussing this morning in the future.

Thank you.

[The prepared statement of Commissioner Gibbs appears in the appendix.]

Senator PRYOR. Mr. Commissioner, thank you for that very, very fine statement. I appreciate the kind remarks. We will go to questions for you momentarily. But we will first hear from the General Accounting Office.

Mr. Dodaro, we look forward to your statement, sir. I notice that you have several of your team assembled with you.

I want to compliment both the IRS and the GAO for working together on what I might call a joint venture. I think this is very constructive. I think that ultimately this type of joining together to look at common problems is going to be very, very meaningful.

Mr. Dodaro, thank you for coming. We look forward to your statement. I would like, if you could, to hold your statement to about 10 minutes, maybe 15, so we can go to the questions.

STATEMENT OF GENE DODARO, DIRECTOR, GENERAL MANAGEMENT ISSUES, GENERAL GOVERNMENT DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY JENNIE STATHIS, DIRECTOR, TAX POLICY AND ADMINISTRATION ISSUES, JAMES WATTS, ASSOCIATE DIRECTOR OF CENTRAL FINANCIAL OPERATIONS AND LAW ENFORCEMENT SYSTEMS ISSUES, IMTEC, AND JEFFREY STEINHOFF, DIRECTOR, SYSTEMS AUDITS, AFMD, GENERAL ACCOUNTING OFFICE

Mr. DODARO. Good morning, Mr. Chairman. I will keep my remarks to the 10 minutes.

It is a pleasure to be here today to discuss the critical management challenges facing IRS. I would like to introduce the people with me here today. On my far left is Jennie Stathis, Director of Tax Policy and Administration to GAO. At her right is Jeff Steinhoff, the Director of Financial Management Systems in our Accounting and Financial Management Division. And to my immediate left is James Watts, who is the Associate Director for Central Financial Operations in our Information Management Technology Division.

Let me begin my remarks by echoing the comments that have been said this morning about the cooperative nature of this effort. It is not often that the GAO is welcomed into an agency and that people are really committed to working with us to try to make improvements. I think Commissioner Gibbs' involvement and support of this project, along with the members of his top team who are here today, in working closely with us were very important to undertaking this venture. They are to be commended highly for their willingness to have a candid assessment done of the IRS and look for opportunities to improve.

The report resulting from the joint review, as you pointed out, contains about 40 recommendations. This morning, though, I would like to focus on four areas that I think are the most critical management challenges facing the IRS. It is very important that these challenges be addressed successfully if IRS is to assure quality service to individual taxpayers.

The most pressing challenge, as you pointed out in your opening remarks, is to modernize the outdated and inefficient computer systems. The current computer system restricts in many ways IRS's ability to provide service to taxpayers. Also, it is not expected to be capable of meeting growing workload demands beyond the next 3 to 5 years. As a result, timely modernization is essential. This is likely to be an enormous undertaking. It is going to entail a large

investment of public funds, will take several years to complete, and require application of state-of-the-art technology.

Consequently, IRS must assure it is organized to provide effective leadership for this effort. Under the reorganization that the Commissioner alluded to in 1987, IRS made some important changes. We think it has put them in a better position to manage this area. However, IRS also needs to seriously consider the benefits to be gained by establishing a separate Deputy Commissioner whose sole responsibility would be managing information technology and overseeing this modernization effort.

In order to make this effort successful, IRS also has to give a high priority to increasing the level of technical expertise among its managers. IRS managers have a lot of expertise in managing operations, but less expertise in the area of state-of-the-art technology.

Challenge number two is to strengthen IRS's financial systems. Although IRS will soon collect a trillion dollars annually in taxpayers' money, their accounting systems have weak internal controls and often produce inaccurate and untimely information. IRS has recognized fully these problems and is taking some actions to resolve them. But they historically have had problems achieving success in this area.

There are two keys to making sure that these areas receive the needed improvement. One is the establishment of a chief financial officer within IRS who has sufficient authority to direct the financial activities of the agency. Second, Mr. Chairman, we think it would be very beneficial to have the financial statements from the Internal Revenue Service audited annually. That way there is a discipline imposed upon the system, just like in the private sector. Congress also will have the knowledge that the information that is being generated is reliable.

Challenge number three involves addressing service and work force quality concerns. IRS has begun a good effort, as the Commissioner pointed out this morning, starting this quality process and changing the production focus of IRS to more one of customer service. It embodies a number of good principles that private sector companies have used—such as employee involvement through the union agreement. But like efforts in the private sector, it is going to take a long time to change the culture of the IRS to make customer service a reality at the operating level on a daily basis.

I think continued employee involvement and support from IRS leadership is essential. Additionally, a key here is to develop good performance measures so that IRS can really know whether it is improving quality service or not.

Also, we believe the IRS is experiencing a serious deterioration in its capability to attract and retain quality people. This is a critical factor particularly with the Internal Revenue Service. It is a problem with a number of Federal agencies, but it is especially important in IRS because of their daily interaction with the public. The quality of services that the public receives from IRS really in many ways shapes their opinion about how our Federal Government operates. Noncompetitive pay is a real problem and it is hindering the IRS in this regard. In addition to resolving the pay issue which IRS cannot do alone, they need to collect some better infor-

mation on the quality problems that they are having in order to affect other solutions. But the overriding factor here, I think, is the noncompetitive pay.

The fourth and final challenge I want to mention this morning is to improve oversight over IRS's massive decentralized field operations. The Commissioner needs to maintain a system of checks and balances within the Internal Revenue Service to insure that there is uniform fair treatment given to all taxpayers and that field performance is assessed on a continuing basis. Ninety-four percent of IRS's resources are located in its field activities. So it is very important that IRS have an affective oversight process.

IRS has been without an oversight process for some time now. Also the resources that have been devoted to internal audit have decreased 13 percent between 1980 and 1988. We think this places the Commissioner and his top people in the vulnerable position of not having good objective information and feedback on what is happening in the field. The IRS has moved, based on the recommendations in the joint report, to restore some of the resources to internal audit. But that is an area that still needs to have some attention in the coming years.

Additionally, as the Commissioner pointed out, IRS is developing a new business review process as a means to have a regular oversight and review done of the field activities. The process will report on how well IRS has implemented their strategic objectives. We urge them to complete that effort as soon as possible and to begin performing reviews on a regular basis. The objective here would be to have every region and each of the functional activities reviewed on an annual basis. The Commissioner can then have an overall picture of how well they are accomplishing the objectives outlined in their strategic management system. It is very important to have that.

In closing, Mr. Chairman, I want to emphasize that the IRS must confront each of these four challenges directly. Failure to do so will serious erode its ability to serve the taxpayers in the future years and to enforce the Nation's tax laws. We think IRS has made a good start under Commissioner Gibbs' leadership. The organization that they put in place in 1987 was very good because it clarified accountability within the Service, something that had been a problem before. It enabled better communication and decisionmaking at the top levels in the Service, which we think is important.

Also the development of the strategic management plan is very important. IRS is one of the few Federal agencies that I have seen with a process to look long term. I encourage you to participate with them in that process. The real key now is to insure that in the coming years the IRS continues the attention given to implementing all the recommendations in the joint report. We intend to work with them, to monitor their process, to help them in any way that we can. Continued congressional interest is very important in this regard.

Mr. Chairman, your holding this hearing today is evidence of your interest in strengthening the IRS. We believe it is an essential first step in understanding its enormous challenges and enabling the Congress and IRS to work together to improve service to the American taxpayer.

That concludes my summary.

[The prepared statement of Mr. Dodaro appears in the appendix.]

Senator PRYOR. Thank you very, very much, Mr. Dodaro. Let us begin talking about our computer system, the computer network. We hear a great deal about it as a result of some of the breakdowns. We have talked about Philadelphia in 1985. We are talking about the possible breakdown, or the capacity of being taxed to its maximum and more by 1992 or 1994.

What is the basic problem with the computer system now that we have in IRS? How do we fix it? What is being done to fix it? How much money is it going to take to fix it? And if we appropriate the money, will it be used wisely?

Now, I will first ask our friend from the General Accounting Office that little series of fluffy questions. Then we will let Mr. Gibbs respond.

Mr. DODARO. The basic problem, Senator, is that the system was designed in the early 1950's and 1960's technology. Now, Mr. Watts has been monitoring the computer systems, and I am going to let him explain the problems and what we see as the problems that need to be addressed.

Senator PRYOR. Well, Mr. Watts, I know very little about computers and I do not want to go to school on the whole business today. So, if you would, just give us some observations and do not be too technical.

Mr. WATTS. I definitely will not do that, sir.

As Gene indicated, the problem with the current system is that it was designed over 30 years ago. One of the best ways to illustrate the problem with the current design is to describe how it processes tax returns. When a taxpayer files a tax return in a service center, whether it is Memphis or Austin, the tax return arrives in paper form and data from it is entered into a computer system. That data is put onto a tape and hand carried to another computer system, run on that computer system and then put on another tape. The tape is trucked to a nearby airport and flown back here to the Washington, DC area and then trucked to Martinsburg, WV to run on another computer system. After that is done, tax data is dumped onto another tape which is trucked and flown back to the service center to get a refund or a tax bill sent to the taxpayer.

What I am describing is a system that is very disjointed. It is fragmented. It comes in pieces. It is based upon a 30-year-old design. Because of that it really does not provide timely service to the taxpayer. Now, the current technology, as you indicated in your opening remarks, is fully here; major corporations are using it. But today, IRS does not have its systems designed to take advantage of that technology.

We believe, as we said in the report and in Gene's remarks, a third Deputy is very important to make the modernization happen. It is important that the third Deputy and his senior management team have the technical expertise, but equally importantly the business sense—the business management approach—to really apply that technology.

Senator PRYOR. Mr. Watts, GAO's management review report talks about the possible computer shortages and capacity that could be reached as early as 1992. It is my understanding that the

IRS says this really might not happen until 1994, 2 years down the road.

Now what is our date for reaching the capacity in our computer system?

Mr. WATTS. I think the time frame that IRS has to be concerned about is 1992 to 1994. It is very iffy as to whether the current systems will, in fact, provide sufficient capacity during that time frame. They cannot be upgraded beyond what they are today to provide more capacity.

Senator PRYOR. Now just a minute. They cannot be upgraded?

Mr. WATTS. No.

Senator PRYOR. Why?

Mr. WATTS. Because the hardware configuration installed today is the largest available for that hardware model. IRS, however, can do things to optimize its use.

Our point is that it takes a long lead time to acquire this equipment, to put in new equipment. It takes sometimes as long as 2 years to do that. So our point is that you need to look at that horizon—at earliest it is going to be 1992—and you need to start the ball rolling today to get the capacity you need for the 1992, 1993, 1994 time frame.

Senator PRYOR. All right. How do you start that ball rolling? What happens? How does the ball start rolling?

Mr. WATTS. Well, the Internal Revenue Service has to go through process of defining its requirements and putting that into documentation that goes through Treasury, to the OMB and GSA to get approval to go out and spend money to go out——

Senator PRYOR. How much money?

Mr. WATTS. In this case?

Senator PRYOR. Yes, sir.

Mr. WATTS. I cannot comment as to what it would cost to replace those systems today. But as you have pointed out earlier in your remarks, the redesign effort is going to be in the billions of dollars. The last major procurement that IRS went through to provide the existing hardware was in a $200–$300 million range.

Senator PRYOR. Mr. Commissioner.

Commissioner GIBBS. Mr. Chairman, we certainly agree with the analysis of the shortcomings of our present system that have previously been outlined. It is very paper intensive. One of the things that we are doing today, within the Internal Revenue Service, is trying to develop a system and approach that will deal with the problems of having to manually deal with the very, very substantial amounts of paper—approximately 200 million, returns—that are coming in to us. We are dealing with them as Mr. Watts pointed out, with a system that is literally from the ice ages when you look at modern computer technology.

Now, in terms of what we are saying here, let me outline what I understand GAO is saying in its comments. They are not saying this will be a problem. They are saying, this could be a problem. If you do not do things, this could be a problem within a time frame of 1992 to 1994 with respect to the capacity issue. We at IRS have developed and provided concrete approaches as to how we intend to address the problem in the 1992 to 1994 time frame.

As I understand the GAO response, the response is, well, if you do what you are planning on doing, and we agree it could be done within that time frame, then I think what I have heard is that they agree that it would address the issues, the concerns, that we are talking about. So what we are down to is, can we, in fact, produce on the plan that we have and the approach that we have to make the changes that we need to make so that we will not have a problem within that time frame? That is precisely what we are about today, but it is only a part—but a very important part—of the upgrading of our computer technology.

I would also like to ask Mr. Wedick, if he would, to comment on those general thoughts and to give you any additional comments he would prefer to make at this time. He is at the present time our chief information officer within the Internal Revenue Service.

Senator PRYOR. Mr. Wedick.

Mr. WEDICK. Mr. Chairman, thank you.

We have, as was pointed out earlier, produced an information systems development plan which lays out a blueprint for how we are going to move from the current system we have to the ultimate target system that is the full replacement of the current system. We have also developed in that process what we refer to as an "interim architecture"—where are we going to be at a certain point in time? How are we going to address the 1992-1994 problem?

Essentially, the 1992-1994 problem is going to be addressed by bringing on new systems which will take part of, and progressively more of the work off of the current computer systems until the old systems are completely phased out. They are already starting to cause a little problem here and a little problem there. With this plan that we have, and this is a basic objective of our whole information systems modernization effort, we hope to position the Internal Revenue Service in the 1990's so that we will be in the same posture as leading financial institutions will be.

So that in the context of being like a Federal Express, conceptually, that is clearly where we want to go. If we are not able to get to that point—but we are very confident we will—we are not going to be able to provide the quality service the American taxpayer needs and deserves.

Senator PRYOR. Mr. Wedick, we understand from the report that we have some slippage in dates. For example, earlier testimony indicated that we were going to have this whole system in effect by, I think, 1995 and now it has moved to 1998. Am I correct?

Mr. WEDICK. It may have been that the very early estimate was 1995. That is quite an old estimate. The 1998 estimate is an accurate estimate at this point. I guess I would caution that even if we do not have the entire system in place in 1998, that does not portend the collapse of the tax processing system. What it means is, it will obviously take us just a little bit longer to get everything done that we want to get done.

Senator PRYOR. Is it wrong to say that it'll take roughly one decade to get this system where it should be?

Mr. WEDICK. No, Mr. Chairman.

Commissioner GIBBS. John, let me comment.

Senator PRYOR. Mr. Commissioner.

Commissioner GIBBS. Mr. Chairman, I would like to comment. What we are basically doing is bringing the system on in stages. We have gone to other government agencies, we have gone to the private sector and so forth, and talked to them about what makes sense in terms of how to make the transition from our present system to a system that, as John Wedick said, would be equivalent to a Federal Express system at some point. They have urged us, for a variety of reasons, to think in terms of bringing that system on in stages. It does not mean that you have to wait until 1998 to see the final benefits.

Senator PRYOR. All right.

Commissioner GIBBS. I want to stress that because I think that is important.

Senator PRYOR. Am I correct in saying that the Philadelphia fiasco in 1985 was brought about because of trying to bring in in stages a new computer system and the system did not relate to the existing one. My question, if that is true, is this——

Commissioner GIBBS. I do not think it is true, but go ahead.

Senator PRYOR. What is going to happen if we try to implement a partial new system, a disruption in the process, from those years we were trying to bring a new system on line? What happens to the taxpayer out there? That is what I am concerned about.

Commissioner GIBBS. Can I respond to that?

Senator PRYOR. Yes, sir.

Commissioner GIBBS. I think it is very important to go back to 1985 and contrast what happened in 1985 with what we are talking about with this approach.

In 1985 we did not bring it on in stages. We changed hardware and software in each one of our 10 service centers in 1 year. We did not run things in tandem. We did not keep the old system as we were bringing the new system on. We dismantled the old system and brought in the new system.

Another difference is, that the 1985 effort was largely seen as a functional change. That is to say, it was viewed as belonging to some of our functions that had to do with computers. They were responsible for it and it was their change.

What we are learning, Mr. Chairman—and this is part of what GAO is also commenting on—the change that we are going to make is going to be a change that affects all of our organization, and it is up to all of our executives, all of our managers, and ultimately all of our employees to understand that. This is not something that is just going to occur in the service center. This is not something for which only Mr. Wedick and his folks are responsible. What we are doing is beginning to educate, train and have all of our employees understand the magnitude of this, the importance of it, how it is going to affect their jobs, how they relate to it. That is very different from the way we approached it in 1985.

Senator PRYOR. What is the overall cost we are talking about? What are you going to ask Congress to ultimately appropriate?

Commissioner GIBBS. Because we are still designing the system, and because it will take place over a period of time—over a decade—we are still in the process of costing that out. We can give you the estimated cost of what we are going to be implementing. I

will be glad to furnish that for the record. But this is going to be something that comes over a period of time.

[The information follows:]

ESTIMATED COST OF IRS' REDESIGNED TAX SYSTEM

IRS estimates total costs over a 10-year period to be approximately $3-$4.5 billion. These funds include the costs of all ISD initiatives/projects for the entirety of their respective system's lives. This figure is based upon development, implementation, and operational costs over and above the base staffing and operating costs of the current tax processing system. More refined cost data is expected to be available at the end of the 1989 calendar year.

Commissioner GIBBS. Frankly, one of the things we are being told is that in the next decade many of the portions of what we are going to be doing over the next decade are going to come down drastically in cost from where they are today. So in terms of giving you figures, in terms of what this is going to cost, it is going to be very difficult to do that until we actually get through the process.

Senator PRYOR. The Department of Defense told us that in the early 1980's, some of these weapon systems and computers, et cetera, were going to go down dramatically during 1980 up until now, but it looks like they have gone up. So I am not sure that I buy the assumption, Mr. Gibbs, that these are going to go down. It certainly did not follow through in that way with the Department of Defense.

Commissioner GIBBS. Mr. Chairman, I will simply say that the cost of not approaching this, of not making the changes, in terms of the impact on tax administration, on taxpayers, our customers and your constituents, is far more in my opinion that what the cost will be of bringing this on.

Senator PRYOR. It is my understanding that the estimate to bring this system up where we need it is $11 billion. Is that a figure that has been talked about within the Internal Revenue Service.

Commissioner GIBBS. I am unaware of that figure, Mr. Chairman.

Senator PRYOR. Has the General Accounting Office heard this figure? I have heard this figure.

Mr. WATTS. I have not heard that figure. I have heard figures more in the $3-$5 billion range which are preliminary estimates that were made a couple of years ago. As the Commissioner said, though, they really will not have a good idea of what the cost of it is going to be until near the end of this calendar year.

One point of clarification here, I think. It is true that the costs do come down over time, primarily in the hardware area. But the real cost, the cost escalation is in the software area. That is a very people intensive process to design and develop those. So I still believe that it is very important for the Internal Revenue Service to come up with an estimate of what this is going to cost. It is going to be in the billions of dollars. I think the taxpayer has a need to know that and certainly the Congress has a need to know that. Recognizing up front that there will be some variability in those costs because it is a projection. But it is something that needs to be done.

Senator PRYOR. Mr. Watts and Mr. Dodaro, we have talked in the past about the IRS establishing a third Deputy Commissioner for

information technology. Do you think that is important? I think that is one of the recommendations that you make. I understand the IRS has not supported that in the past.

Mr. DODARO. The recommendation that we made in the report was based on the fact that IRS had just went through a reorganization in 1987. At that point, as the Commissioner noted, John Wedick was designated the chief information officer for the agency. Prior to that it was not clear who exactly was in charge.

Senator PRYOR. Right. I would like to applaud that first step. Let the record show that.

Mr. DODARO. We think that was a good step, too. Given the newness of that change, what we recommended is that IRS reassess the 1987 reorganization after it is in place for a year. We are in the process of working with them right now doing that, to see if there is a need to establish this third Deputy Commissioner with separate responsibilities for information technology. It is very important that this be given serious consideration in the reassessment.

John has done, in our opinion, a good job. But he also has other responsibilities. He is in charge of human resources for the agency, financial management, and the budgeting area as well. We think given the magnitude of the change we are talking about, whether it be $3-$5 billion or $11 billion, it is going to be a big effort. As the Commissioner pointed out, it is going to cause changes throughout the agency. We think that the IRS really needs to consider whether or not there ought to be full-time leadership at the top here to really monitor that change.

Senator PRYOR. Mr. Gibbs, do you have any comment?

Commissioner GIBBS. Yes. I would like to comment.

I agree that our information technology needs very strong leadership, and I would suggest there are at least four aspects of that. First, leadership is needed to provide information technology vision and directional guidance within the organization. Second, leadership is needed to educate and rally support from our internal and external customers. Third, leadership is needed to obtain the necessary budget on human resources. And finally, I would suggest that leadership is needed to move the Internal Revenue Service from strategy through planning to operational implementation.

Now, the issue that we are really discussing is how this should be done. It seems to me that there are at least three alternatives. One is to leave the responsibility where it presently is, with the Deputy Commissioner who also has authority, as well as responsibility, for human resources and budget resources. Another possibility is to create a new Deputy Commissioner who would have responsibility and authority for information technology but not for budget and human resources. And a final approach would be to establish an Assistant Commissioner below the Deputy Commissioner in charge of information technology.

As Gene indicated, we are evaluating all of these alternatives and plan to have a response toward the middle of this year, in which our Board of Directors will participate.

I thought it was interesting that on page 60 of the GAO report, they look at what the private sector is doing in this area. They indicate, and this is a quote, "Three of the managers"—and these are the chief information officers—"report to the Chairman of the

Board or the Chief Operating Officers, and three report to the next lower level."

So in the private industry, based on the GAO report, it is not absolutely a given fact that you would have someone reporting to our chief executive officer, as Mr. Wedick does. It is also not clear to me that, if you are going to approach the magnitude of this and you are asking someone to do it, it is not clear to me whether they would tell you that they would like to give up the opportunity to have the authority over the budget resources and over the human resources. By the same token, I do not mean to anticipate, in terms of prejudgment, the decision that will be made. All I am suggesting is that the important thing is to focus on what the person is going to do, as opposed to where in the organization the person will be located. Further, you must be sure that however you designate the person, you in effect have a clear understanding as to how that person is going to have both the authority and the responsibility to be able to do what you want them to do.

Senator PRYOR. If Congress gave the Internal Revenue Service today—let us say a check for $3 billion, $4 billion, $5 billion or $11 billion, whatever the case may be, to implement the state-of-the-art technology that the IRS apparently is going to need, could the IRS absorb this money and spend it efficiently? Is it prepared to take this money and to spend it with accountability and efficiency?

I must say that I am a Doubting Thomas in this area. I do not know that the IRS is ready to take on this expenditure because I am not sure that the plan is in effect of what we want.

Commissioner GIBBS. Well, let me explain what we are doing. In terms of the plan that we have, that Mr. Wedick outlined, in terms of the overall plan itself and also the interim architecture that is in place, that is something we are doing. We are developing a focus within the organization.

But let me make it clear, Mr. Chairman, that we are relying on resources outside the organization as well. Some of the most respected organizations in this country, including those in the private sector, are assisting us with this project. I would like to ask Mr. Wedick to further comment on specifically who we are involving at this point to supplement our own resources.

John.

Mr. WEDICK. Thank you.

As an example, we are asking the National Institute of Standards and Technology to evaluate for us both current and emerging technologies, in the context of their usefulness—that is, the usefulness of such technologies in applications in redesigning the system.

We will soon be in a position to have the National Academy of Sciences come in and conduct a two-phase evaluation for us. First, they will look at the various information systems that are in current use, to see how well they fit into our overall long-term effort. The second phase will be to evaluate very specifically our long-term effort so that we can get from them their independent views and their insights in terms of undertaking this effort.

This is a massive effort. There is no question about it. We want to restate what Larry said, that it is an evolutionary approach that we are using—a modular approach, putting in pieces one at a time, making sure when we put in those pieces that we also have the ex-

isting system there running parallel until we are very sure that the new piece, in fact, works.

So, as the Commissioner said, throughout this effort, we will have outside contractors with their expertise working with us. It is going to take all the expertise that we can marshal within the Service and from the outside to accomplish this massive effort.

Senator PRYOR. Mr. Wedick, we are running overtime right now. I am going to move out of the computer business into some other areas of the IRS. But let me just ask one final question. What degree of priority is being given to the security of these systems? In other words, the computer security, the problem that we have we hackers. I assume that a high priority is being put on this because of the confidentiality of an individual's tax return.

Mr. WEDICK. Absolutely the highest priority in terms of concern for both security and for privacy.

Senator PRYOR. I am going to move, if I might, to some of the problems concerning the accounting services. We are not going to stay in this area too long. But the General Accounting Office report, Mr. Gibbs, indicates that a doubt has been cast on the IRS to sort of keep its own books. If I might address a specific situation—the IRS estimates that in 1986 721,000 Federal tax deposits, totally $6.5 billion resulted in erroneous bills, penalties, refunds, or inquiries for delinquent returns. The report states that this problem is causing confusion and frustration for more than half a million taxpayers out there in the country.

Now, this was a situation once again in 1986. I am wondering if this has been corrected. I am going to ask the General Accounting Office if they are monitoring this and if an update were done on this today, what would be the results today.

Let us ask the General Accounting Office first and then we will go to Mr. Gibbs.

Mr. DODARO. We are aware of some changes they had made in that basic process. We have not yet went back in and monitored it to see if the changes have, in fact, resolved the problem.

Senator PRYOR. I will, by the way, at the proper time respectfully request the General Accounting Office to give us an update in this very area. Because I think this is an area, Mr. Gibbs—and I say this respectfully—where the taxpayer becomes extremely frustrated. I think the Congress certainly hears from our constituents. I have a letter or two I might read into the record in a moment.

I wonder, Mr. Gibbs, if you would like to explain or comment on this?

Commissioner GIBBS. I would, Mr. Chairman.

I share your concern about this area. Let me point out that almost 80 percent of our revenue receipts in this Federal Government come in through Federal tax deposits, or FTD's. When I came to IRS in August 1986, we were having 30,000 mistakes a week that were occurring in the FTD area. What that means, Mr. Chairman, is 30,000 receipts were coming in and being credited to the wrong account.

Mr. Chairman, we tried to fix this problem for years. We had projects, we had task forces, we have done this, that, and the other thing, we had even redesigned the form.

This was one of our first quality improvement projects. We asked our folks who had received quality training to get into the FTD area with the erroneous deposits. They asked us when we wanted an answer. We told them we wanted an answer when they had done the work. It took them over a year. They had over 150 recommendations that we implemented. We have gone from 30,000 a week to down to less than 4,000 a month and we think we can improve it even more.

This is one of the quality improvement projects for which we were given an award by the Office of Management and Budget. In terms of the impact it had, both on the cost-savings to the Federal Government and certainly the benefits to the American public, the project was immensely successful. This is one example of what we think the quality improvement process can do in terms of making real changes.

Senator PRYOR. Now, at this point you say that we are making progress in this particular area. Significant progress, is that correct?

Commissioner GIBBS. I would say 30,000 mistakes a week to about 4,000 a month is pretty good progress. Yes, sir.

Senator PRYOR. Once again, we are going to ask the General Accounting Office to sort of attempt to verify these figures. I hope they will be verified. And I hope that progress is being made.

Let me just ask one question. Once again, it relates to the ability of the IRS to absorb great quantities of money to go into improving the quality of the service between the IRS and the taxpayer. I understand—and we did cite an internal audit report from IRS—that 2,000 more computer terminals than it actually needed were purchased and then all of this despite a utilization study which stated the IRS did not need these terminals was a $25 million expenditure. I think it requested even 5,000 additional terminals in addition to the 2,000 more that it purchased.

This is what I am concerned about in trying to just say that we are going to cure all of these problems with additional appropriations or additional budget outlays. I am concerned about this area.

Commissioner GIBBS. Mr. Chairman.

Senator PRYOR. Yes.

Commissioner GIBBS. Could you give me the date of the report and the time frame within which this related? I am not personally familiar with this and it would really be helpful to know.

Senator PRYOR. I will supply that date.

Commissioner GIBBS. We will also be happy to supply an answer for the record.

Senator PRYOR. This is from an internal audit report of the IRS. This is not General Accounting doing this.

Commissioner GIBBS. I understand. We will certainly be happy to respond if you can provide us with that information. We would be happy to respond with a comment for the record on it.

Senator PRYOR. Well, I do have that report. I do not see a date on it. Do you not date things?

[Laughter.]

Commissioner GIBBS. Yes, sir; we do.

Senator PRYOR. Oh, June 25, 1986. That was before you came on board.

Commissioner GIBBS. Yes, sir.

Senator PRYOR. It looks like a lot more terminals were purchased and ordered than were actually needed or requested.

Commissioner GIBBS. If that is the date of the report, then I would suspect that it was a prior time before 1986 where this matter occurred. I will, certainly, get into it and give you a response for the record on it.

Senator PRYOR. We would like that response for the record, Mr. Gibbs.

Commissioner GIBBS. Yes, sir; I would be happy to.

[The answer follows:]

ACQUISITION OF COMPUTER TERMINALS

The terminals in question support the Integrated Data Retrieval System (IDRS). This is a data entry and retrieval system that processes transactions and inquiries to taxpayer accounts through terminals located in IRS offices nationwide. The terminals are linked by communication lines to mainframe computers located in ten service centers and Martinsburg Computing Center.

It is inaccurate to say that these terminals are unneeded. The actual need for these terminals has greatly exceeded the rate of annual growth that was anticipated in a 1982 feasibility study. To date, the IRS has distributed almost 12,000 terminals and even more are required, particularly for Taxpayer Service and Returns Processing activities. There are approximately 2,000 terminals left on the IDRS Terminal Replacement Contract which will only be procured with available funding. The first priority is to provide 800 of these terminals to Taxpayer Service and Returns Processing. If the IRS is to serve taxpayers in the timely manner that they expect and deserve, these terminals are a necessity.

Senator PRYOR. We do appreciate that.

I am going to ask one or two more questions. I see our friend Senator Bradley of New Jersey is here. He may have comments or questions for the Commissioner or for the General Accounting Office.

What is the practical effect—let us just talk about once again the taxpayer. That is what all this is about anyway. What is the practical effect on taxpayers when the IRS fails to adequately maintain a revenue accounting system that is proper? Does that mean they do not get their refunds on a timely fashion? Does it mean they are going to have their assets or property seized because of error? Will additional penalties be stacked in a situation that is not justified? What are the practical effects here.

Mr. DODARO. I want to ask Mr. Steinhoff, who has been monitoring the revenue accounting system, to respond to that.

Senator PRYOR. Mr. Steinhoff, thank you.

Mr. STEINHOFF. Mr. Chairman, basically all of those things affect the quality of the service. The taxpayers are entitled to have an accurate accounting of their accounts. To the extent there are errors—and IRS has major challenges, as outlined today in the whole information area—this permeates to the whole revenue accounting side. We are dealing with very old systems—20 to 25 years old. They are error prone. It is very, very difficult when we have massive amounts of paper not to have errors. This gets back to the quality of service. It is a very difficult task that IRS must face working with those systems today.

Senator PRYOR. What about the situation we talked about? We just discussed it a moment ago in the opening, that was the RIS project which was discussed earlier when the GAO says, and I

quote—I believe this is the area where there had been an explosion in the cost overruns or the estimates of what this system would cost.

Quoting GAO, "The IRS could not provide us with the actual amount spent on the project before its cancellation because IRS does not have a system to track the costs of such projects." I think this was a $120 million expenditure.

Mr. STEINHOFF. Right.

Senator PRYOR. Our point here is saying that, if the IRS requires us as taxpayers to keep a good system of accounting and a justification for exemptions, deductions, records, et cetera, what sort of accounting system are they going to use if we give them a great deal more money to upgrade their systems?

Mr. STEINHOFF. One of the recommendations we are making in our report is that the IRS develop a good cost accounting system.

Senator PRYOR. And it is not present today, am I correct?

Mr. STEINHOFF. Right. It is not present today.

The problems we are highlighting here, however, are not atypical to the rest of the government. We find across government that appropriation accounting is really the key focus and that agencies do not have good cost accounting. Often times when we look at systems, especially those in trouble, agencies can generally provide the contractor costs. They generally cannot provide the internal costs. It is very, very key, both for this type of project and really for the day-to-day operations of the IRS, that they have a good cost accounting system and can measure results using information from those systems.

Commissioner GIBBS. Mr. Chairman.

Senator PRYOR. Mr. Commissioner.

Commissioner GIBBS. Could I just ask to clarify something here?

Senator PRYOR. Yes.

Commissioner GIBBS. I think it is very important to our discussion. We are talking about three things. One is a system whereby we keep up with what is appropriated and given to us to run the Internal Revenue Service. That is called administrative accounting.

Another thing we are talking about are the revenues that we receive from the American public. That is called revenue accounting.

The third thing that was just mentioned is cost accounting, the cost accounting techniques by which we evaluate the cost benefit and the other effectiveness of our systems.

Now, I want to make the record clear that while it is certainly true that we do from time to time make mistakes with respect to taxpayer accounts—and certainly the FTD issue was a key issue there—I want to make it very clear that we think we do have a program, a process, and systems in place where we do keep track of and we can for the most part—and when I say that, I mean with relatively few exceptions—tell taxpayers what their accounts are and keep up with those accounts.

I do not want the record to be left on the basis that this is a real problem at the Internal Revenue Service today. I do not believe it is.

Mr. DODARO. Senator, there are two points on the accounting area that I would like to make.

Senator PRYOR. All right.

Mr. DODARO. Point number one is that most Federal agencies do not have an audit done of their financial statements annually. This is a key problem. The Federal Government requires State and local governments to have audits done annually of their financial statements. It is a routine practice in the private sector.

Let me just illustrate what can happen there. The accounts receivable at IRS have grown tremendously in terms of the figure over time. But the Service was unable to quickly tell why that figure had grown so much over time. Our point is, if you have routine audits done of the financial statements, it will make sure that the information coming out of the systems is reliable.

You need the discipline of a financial audit. It will spot weaknesses in some of the accounting systems that should have been highlighted a lot earlier than they are currently coming to light.

Point number two is attention to accounting matters. This is a problem in every Federal agency that we take a look at. It is basically that the accounting systems are relegated to sort of housekeeping functions as opposed to given a lot of attention. That is why we think you need a chief financial officer at IRS, to make sure that the accounting issues, given the magnitude of the IRS's responsibilities for collecting revenues, are given top priority attention and that these accounting system problems are dealt with directly.

Senator PRYOR. Here we have an—I am citing a case—the RIS system we will call it, RIS—$120 million expended and then the project was canceled. Would that have shown up in an audit? And two, would the audit have discovered where that $120 was expended and what expenses for which area of that project.

Mr. DODARO. The audit would have disclosed where the money would have been spent.

Senator PRYOR. How much effort would it take to——

Mr. WEDICK. Can we comment, Mr. Chairman, on that?

Senator PRYOR. Yes, Mr. Wedick.

Mr. WEDICK. I have two points. First, we did not spend $120 million on RIS. The report states that when the project was canceled in March 1986, its implementation schedule had slipped some 18 months and its cost estimate was $120.5 million. In other words, the cost estimate for this kept rising but we did not issue a request for proposal to get any contracted work on this. What we actually did expend was staff resources in putting together the plan, which is an infinitesimal amount compared to $120 million. So $120 million was not spent on this.

Point number two, the decision to cancel this effort was a decision that was made by those in the Internal Revenue Service who were responsible at the time. It was not a decision forced from the outside.

Senator PRYOR. Would you restate that, Mr. Wedick. It was made by the IRS not by outside——

Mr. WEDICK. The decision was made by those who were responsible for information systems at that time in IRS. I was not responsible at that time, but my predecessors made that decision upon a review of the project. I can supply more data for the record.

[The additional data follows:]

HISTORY OF RIS PROJECT

It is important to note that the initial $8.5 million cost projection for RIS was only for the original RIS concept. This projection changed as the system concept was refined during the system development process. When the projected costs had risen to $120 million, IRS officials decided that these costs outweighed the benefits that would be derived from RIS, and canceled the initiative. The 18 month slippage in the RIS schedule was the result of a conscious decision by IRS management to allow for a more orderly implementation of RIS.

Approximately 26 staff years at a cost of $912,000 were dedicated to the RIS initiative. This amount represents the total staff and dollars used from the project's inception in August 1983 until it was terminated in March 1986. Virtually all of the staffing was devoted to developing software for the system. No equipment was procured for RIS.

Senator PRYOR. Thank you, Mr. Wedick.

Mr. Dodaro—I am getting ready to yield to Senator Bradley—what would it take, how much effort on GAO to do a yearly audit on the Internal Revenue Service? And then, how much effort would it take to audit, for example, Housing and Urban Development or OPM or any other agencies. What sort of work effort?

Mr. DODARO. Well, we have started doing some audits of Federal agencies. It has been in Mr. Steinhoff's division. So I am going to let him comment on that.

But one thing to keep in mind is that the initial cost, given the fact that they have not been done previously, is going to be a lot more than what it would cost once it is being done on a regular basis. But we have done some financial audits and I will let Jeff respond to those.

Senator PRYOR. Well, the 11th Commandment is, we ain't done it like this before.

Mr. DODARO. Right.

Senator PRYOR. I think somehow or another we have got to start doing it in a different way than we have done it. We have got to bring more efficiency here.

Mr. STEINHOFF. I cannot give you today, a precise cost for that type of audit at the IRS. However, our experience in doing financial audits at agencies such as GSA and VA—we are now doing one in the Air Force—shows that they are very large audits. The cost the first year is roughly double the cost in year two, and the costs go down over the first 4 or 5 years. We would be talking about a substantial investment.

However, given the magnitude of revenues, close to $1 trillion, it will buy the IRS, in our view, the importance of providing adequate accountability and reporting to the taxpayer each year on how funds are being controlled and reported on. This is very important.

Senator PRYOR. Thank you, Mr. Steinhoff.

Commissioner GIBBS. Mr. Chairman, I would also like to just comment one final thing.

Senator PRYOR. Yes, Mr. Commissioner.

Commissioner GIBBS. Please do not misunderstand me. We certainly agree about the importance of the three accounting systems that I mentioned. I would assume from my knowledge in the private industry that GAO would also agree that their cost is going to depend, to some extent, on the resources that the Internal Revenue Service has within its organization to address these kinds of issues. That is to say, if we do not have people and resources addressing

the accounting issues it is going to be much more expensive for an outside auditor to come in and put together an audit.

And I will tell you, this is one area where I can promise you that as we get to budget crunches, this is an area that suffers. This is the kind of internal infrastructure problem that when we have a crunch this is where it winds up.

Senator PRYOR. Thank you, Mr. Commissioner.

Senator Bradley.

OPENING STATEMENT OF HON. BILL BRADLEY, A U.S. SENATOR FROM NEW JERSEY

Senator BRADLEY. Thank you very much, Mr. Chairman.

I will be very brief. I understand that this is Mr. Gibbs' last appearance before the Finance Committee. I just wanted to come by and thank him for his cooperation with this committee and with this Senator during a time of enormous transition in the Tax Code. I want to tell you that I think you have done a good job and I wanted to say that publicly and on the record for you today and for those who might look at the IRS from time to time, as we all do, with our lists of things that could be done better. But I think you have really made an effort and you have fulfilled your responsibility in an exceptional way. I wanted to put that on the record.

Mr. Chairman, thank you very much.

Senator PRYOR. He is going to get the big head, Senator Bradley, if we are not careful. [Laughter.]

By the way, while Senator Bradley is here, Senator Heinz and myself have also praised the Commissioner today and I would like to add one more thing. I think that this particular IRS Commissioner, Mr. Gibbs, is leaving office more popular than he was when he came into office.

Did you confer with Ronald Reagan on this? I think he kind of did the same trick. [Laughter.]

I do not know how you do it.

Commissioner GIBBS. Mr. Chairman, I would simply like to thank you, Senator Heinz and Senator Bradley for what you have said.

Senator Bradley, I would like to say to you, sir, that your support, when it was warranted, your constructive criticism—and I am thinking about the W-4 right now—was also warranted. It was well received. I want to thank you publicly for what you and the other members of the Senate Finance Committee have done. Your interest in tax administration and your support of it is something that has meant a great deal to me.

Senator BRADLEY. Thank you.

Senator PRYOR. Thank you, Senator Bradley.

Now we are not quite through with you, Mr. Gibbs. [Laughter.]

Before you get out of town we need to discuss another item or two here. We will be moving right along. We are going to talk about now that 30 percent of the time, according to the GAO, the Internal Revenue Service makes critical errors in responding to taxpayers' correspondence.

Let me, if I might, read just a paragraph from a letter from a constituent—not a constituent, but a citizen. I will not even tell the

State. Well, it is from the State of Michigan. Let me say that. I do not think that will bring them under the gun.

This letter was addressed to the IRS, a copy to me, from this small business person: "Let me begin by stating, I am disturbed by the lack of communication, the professional carelessness, that has led up to this notice of penalty. March 4, 1988, you, the IRS, issued the first notice that a review of our return indicated we had not made tax deposits in sufficient amounts when due. (See attached copy.) I have properly assembled all records . . ." whatever, I will not go through that whole paragraph. "After review by our accountant, the supporting documentation was sent to your office [IRS] along with my request for a follow-up reply from you. No reply was ever received despite this request. Instead, two months later I received a terse impersonal notice that a penalty in the amount of $124 has been assessed. That we are liable for additional interest penalties if payment is not received within ten days."

Mr. Gibbs, this is that black hole that we are talking about in the IRS, where the IRS requests additional information from the taxpayer. The taxpayer in good faith complies, sends them information and goes into some sort of a black hole. The next thing you know, the deficiency notice is there. If not at that time corrected collection seizure begins against—in 90 cases out of 100, I suppose—an innocent, well-meaning taxpayer.

Now, what is being done to look at this particular problem that we find so many people writing us about?

Commissioner GIBBS. Mr. Chairman, I share your concerns. I testified last summer and I will tell you again that this is not acceptable. We agree that this should not happen and we agree that it is encumbent upon us to do something about it.

I mentioned in my opening statement that GAO had made three recommendations. The first one was to ensure that the system that is being developed to help our tax examiners who write taxpayers compose responses to taxpayer inquiries that allow the examiners to view the letters that they have composed. When we got into this, I think all of us were chagrined and I, frankly, was somewhat surprised to find some of the things that we found in our centers.

We have had situations where our individuals were composing letters to send to taxpayers, where they actually were not able to view the finished letter before it actually went out to the taxpayer. We are in the process of bringing that system up to standards. We have very specific plans that we hopefully will be testing later on this year, or next year, to put it in place hopefully next year, that will permit our employees to be able to do that. We are not waiting, though, on that first recommendation. That is a long-range solution.

We also have some short-range solutions. And one is, we are taking the system our employees are using at the present time to compose correspondence and actually making it simpler, and then giving our employees additional training. We are going to be measuring what the impact of that is in terms of the quality of their response.

Senator PRYOR. Mr. Gibbs, I appreciate your response and your sensitivity to this issue. We have discussed this issue personally. We have discussed this issue in public before in this committee.

But let me just read, if I might, from an IRS taxpayer correspondence study, and I quote "that in review of prior studies, reports on the correspondence issue, numerous recommendations which in our view have merit have not been acted on to date."

Now this was a 1983 report. The same problems seem to exist. And then we have a 1987 report citing the same problems with taxpayer correspondence, with the local office or the service centers. And then, of course, we have the 1988 report which is subject to our conversation and discussion today. I am just hoping that the IRS will finally develop a system—and I know we have information technology but we have got to somehow or another put the human element, the person-to-person element back in dealing and corresponding and communicating with the bewildered taxpayer out there.

Because many times we know they cannot get through on the 800 line. We are going to talk about that, hopefully, in a moment. Many times they cannot address anyone in the office, except an answering machine or a computer system that bewilders them to begin with. So I think the problem has been there a long time and I think it still exists.

Senator PRYOR. I just hope that we will priorize this.

Commissioner GIBBS. Can I comment?

Senator PRYOR. Yes.

Commissioner GIBBS. It is not a system, it is not a computer that is going to solve this problem. It is our quality improvement process, quite honestly. At the time that the GAO raised this, I asked a team of our folks to go to work, not to develop information technology, but to do some fairly concrete things.

For example, one of the things that we found as we took a look at it was with the press of the 1985 filing season and the problems out of 1985, we really had not trained our managers in this area, the people who were supervising the people who deal with taxpayers' letters. We have gone back and completed a manager's handbook. We have already completed the training of the managers, and we are going back and supervising the managers to be sure that the work that we have put in is going to help. These are things that we have already done, Mr. Chairman.

We have also gone back and found that our managers were supervising as many as 24 to 28 people. We are now taking steps to reduce that span of control in terms of who they are going to be responsible for.

Another one of the things we found was that a number of problems, as you point out, were repeat problems, where we were having repeat correspondence. We have done a number of concrete things to try to address the repeat correspondence problem.

One involves our Problem Resolution Program actually doing a taxpayer advocacy project where we go out and take a look at what cases were actually handled improperly the first time around, and begin to trace that back to specific reasons and causes that we can actually begin to address. We have addressed things like performance standards for our folks and quality standards that we expect them to meet. And then, as I have mentioned, we have measurement systems in place that let us come back in and take a look at

how we are doing in this area. We will be happy to show them to you. The GAO knows what they are.

I mentioned that we had already taken steps to simplify the format that our people use in answering the letters. When we got into it, this was an extremely difficult thing for our people to use. We have actually made changes in that. So what I am telling you is, that with the process that we presently have, these are not things that are waiting on information systems. These are not things that may happen next year. These are things that have already happened.

Senator PRYOR. Mr. Gibbs, in 1985, if I am not mistaken, the internal audit report indicated that there were about a million letters or a million inquiries, correspondence, backlog—taxpayers' correspondence as a result of computer problems. Now do we have an update on the backlog of cases today that you could share with us?

Commissioner GIBBS. Yes. Again, that comes out of the 1985 filing season. What we have done—and I will ask Mr. Brennan to comment specifically—in terms of addressing the problems that came out of 1985 is to drive the inventories that we had at the time of that report down to the lowest point they have ever been in our organization.

I would ask Mr. Brennan to respond more specifically with that.

Senator PRYOR. Mr. Brennan.

Mr. BRENNAN. Mr. Chairman, in December 1985 we had approximately 1.1 million cases in our adjustment inventory. As of December 1988, that figure had dropped to 341,000 or a decrease of some 800,000, and it is still dropping as of today.

Senator PRYOR. Now, give us the most recent figure you have, please?

Mr. BRENNAN. The most recent figure I have right now is December 1988—341,000, to give the comparison.

Senator PRYOR. That would be the backlog?

Mr. BRENNAN. That is the total inventory.

Senator PRYOR. I see.

Mr. BRENNAN. It was 1.1 million—your figure was correct—in 1985.

Senator PRYOR. In 1985?

Mr. BRENNAN. Correct.

Commissioner GIBBS. This is not a backlog. Those are problems that we are having, but it is not backlog. We are able with our resources to handle those.

Senator PRYOR. All right. Let us talk just a moment about taxpayer services as it also relates to quality. The taxpayer has written in and it may show up in these figures we have just been talking about or the taxpayer may call in.

Now, I have just seen some recent indications in the press that the Internal Revenue Service may start charging a fee, a user fee, to taxpayers who call into the IRS office to ask advice. Now, is this true or false? Could you bring us up to date on this?

Commissioner GIBBS. Let me comment on that because it was raised yesterday. I will make a more specific comment. This was a suggestion that the Office of Management and Budget made to us in connection with the 1990 budget. They simply asked that we

conduct a study to see whether such a thing would be feasible. They agreed with us that the policy issue of whether it should be done has not been addressed yet. The study is simply a feasibility study that they have asked us to make. No policy decision has been made yet.

Senator PRYOR. It would be classified, I guess, as a user fee? I wonder if this passes Mr. Darmon's duck test here? Do you know whether that has been discussed or not? [Laughter.]

But it was an OMB proposal for a study, is this correct?

Commissioner GIBBS. That is correct.

Senator PRYOR. Now, when we get into a situation of talking about the correspondence backlog, et cetera, I would like to ask Mr. Dodaro this question. What is a good measurement? Do you have a measurement stick of how well the service centers of the local offices are doing in handling these cases? What do we measure this standard by?

Mr. DODARO. I want to ask Mrs. Stathis to expand on this. But, basically, the answer to improving service in this area is what Mr. Gibbs pointed out. They are moving to a quality orientation from a production mode. Basically before what they would count, Senator, would be how many letters they have responded to in an hour. And also, how long it took them to respond to the letters. There was no measure in place to determine how well, or accurately, they did respond to those cases. Under the quality and customer service orientation, you would put more emphasis on what kind of a quality job are we doing answering those letters. You would use measures similar to those that we used in our report.

Let me ask Jennie to respond.

Ms. STATHIS. Yes, I really do not have too much more to add. I think that the main point is that the systems that were in place did not really identify for service center managers the amount of the quality problem that they had.

Senator PRYOR. What about moving the——

Commissioner GIBBS. Could I comment on that, by the way?

Senator PRYOR. Yes, Mr. Commissioner.

Commissioner GIBBS. One of the things I mentioned that I think it is very important for you to know is that in October 1988 we completed a review of an evaluative system that we have only recently, within the last year, put into place. It is called "The Program Analysis System."

One of the recommendations in the GAO report, Mr. Chairman, was that we separate out the adjustments-correspondence area, where letters come out of the service center, so we can evaluate that separately. We have now done that. We will be able to do that. What that system does is to pinpoint where the errors are occurring, why they are occurring, and with that information actually make suggestions in terms of what we could do.

So what I want you to know is, there is a measurement system in place to determine where the problems are occurring and why, for us to use to improve the quality of what we are doing.

Senator PRYOR. You are wearing a little lapel pin this morning, Mr. Commissioner, that says, "Quality." I think that you stand for quality in the Internal Revenue Service. And I also think you come

here in your final testimony today before the committee because you feel the quality is being upgraded.

Now, I understand that in 1982 the IRS's response to telephone assistance calls, or the accuracy I should say, has dropped from a high of 85 percent in 1982 to 64 percent in 1988. Now, was this measured by the General Accounting Office or was this an internal audit of the IRS itself?

Ms. STATHIS. That comes from GAO surveys.

Senator PRYOR. Well, what is the reason for the decline in the accuracy of the advice given by the IRS to the taxpayer?

Ms. STATHIS. Well, we caution in our reports that we are never sure from year to year that those statistics are exactly comparable. Particularly with the 1986 tax law, the questions that we asked had to change in later years. But one of the things we talked about in last year's survey was the number of our questions that required the taxpayer assistor to probe, to ask us for more information.

If we asked the question, "is my scholarship taxable," the assistors needed to ask more questions to find out exactly what kind of scholarship we had. If they did not ask that kind of a probing question, we said that they answered the question wrong, whether they happened to have guessed right or not.

The other type of question that we got incorrect answers to more frequently was that related to the Tax Reform Act of 1986. New questions seemed to pose more of a problem than older law type questions.

Senator PRYOR. So to some degree the change in the tax laws has been responsible for this. Is this what we are saying?

Ms. STATHIS. Well, I think there were a lot of things happened last year. One, everybody expected that there would be more taxpayers calling in. As a result, IRS had more taxpayer assistors so there were a lot more first-time people answering telephone calls. I think that the job of hiring and training all of those people had to have an effect on quality.

Senator PRYOR. Do you have any comments, Mr. Gibbs?

Commissioner GIBBS. Yes, I do, Mr. Chairman.

One of the things that I mentioned in my opening statement that I think is significant here, and it follows right in line with what we have just been discussing, and that is that last year and this year, with GAO's help, we have developed a much more sophisticated and a much more extensive system for measuring the accuracy, courtesy and completeness of our calls on the telephone system.

We call it our Integrated Test Call Survey System. With it we will actually make 20,000 or more inquiries of our own people this year, with the cooperation of GAO in terms of asking 62 different questions that cover the spectrum in terms of the tax law. We also have set up, in addition to that, various techniques for identifying and beginning to remedy the causes of some of the problems.

There are comments that I would make to you. One, I do think a change in complexity has an impact here. I would cite, for example, the recent article in Money Magazine, indicating that they talked to 50 practitioners in the private sector about a case, of whom I believe one got it right. The swing was absolutely incredible in terms of the amount of the miss on the question that was asked.

The other comment I would make is this: what we are finding as we work with the GAO in this area is that the process of asking questions to get a handle on accuracy is as much an art as it is a science. It is not an easy thing to do. I would give you one example. Probing is certainly important. It is a very important training tool. And certainly, if you do not get the right facts sometimes, you may give wrong answers. But I was recently told in Dallas, that in the personal exemption area, which is a very standard area on the telephone, we have analyzed that if we asked every single question that we ought to ask to give a right answer, there would be 42 questions that we would be asking.

At some point we are going to have to make the Integrated Test Call Survey System and the analysis of what we are doing face the reality of the budget situation: you cannot have employees asking questions indefinitely before they give answers. That is not going to be easy, because you are struggling with budget on the one hand and how do you know you are really right on the other.

Senator PRYOR. Mr. Dodaro, what is the range and average number of probing questions required for the 62 questions in IRS' integrated test call survey?

Mr. DODARO. Of the 62 questions, 14 require no probing questions, 29 require 1 probing question, 16 require 2, and 3 require 3. The average number of required probes per test question, then, is 1.13.

Senator PRYOR. Mr. Commissioner, you mentioned Money Magazine. I would like to mention a Fortune Magazine article. I read the Money Magazine story that you had referenced to. I am going to put into the record the Fortune Magazine article of last month, I believe it was, which discussed the private sector customer complaint programs. How major American businesses are dealing with complaining customers and turning those complaining customers into loyal customers by basically listening to their complaints.

I am very hopeful that the IRS could consider expansion of the 800 line services to hear the complaints from the taxpayer and make that 800 line more available. I really hope that we can look at this phase of taxpayer service in the Internal Revenue Service.

[The article appears in the appendix.]

Commissioner GIBBS. Can I comment on that?

Senator PRYOR. Yes, sir.

Commissioner GIBBS. There is an interesting recent development that I would mention. One of the reasons why I think you are seeing somewhat of a decline in terms of some of the questions is that back in the earlier years, when GAO was measuring the questions, we got an awful lot of questions that frankly were very easy questions. Where can I get such and such a form? Where can I get such and such a publication?

Those questions really are no longer asked. Those are separated off. We are not getting those. We are not measuring those calls anymore to the greatest extent. The other thing is, we have done something along the lines that you are talking about, Mr. Chairman. We have what we call Tele-Tax now, which is a series of recorded messages where people can actually call in and dial into, in effect, the specific question that they want to have information on.

What we are finding is a very, very substantial increase this year in terms of taxpayers using that type of thing. Another thing they can do is to call in and get information about the status of the refunds. What we are doing, at the same time we are doing this, is using question satisfaction surveys to see how people like this. The other thing that we are doing that I think you should know about, I am spending a portion of each of my weeks—and I have asked each of our other top executives to spend time on this also—reading the complaint letters that come in.

Now, they are being responded to. But what I want to see is the executives in our organization reading and understanding what our customers are saying about us and to us.

Senator PRYOR. Mr. Dodaro, what type of questions did GAO ask in its earlier test call surveys? Were these questions about obtaining forms?

Mr. DODARO. All of GAO's test call surveys have focused on questions of individual tax law. None of the surveys has included a question about obtaining forms or publications.

Senator PRYOR. Mr. Gibbs, that is critical I think. I think that is critical to reestablishing the relationship that we must build between the tax collector and the taxpayer. I applaud you for that, and I know of your initiative there. I think that is an absolutely essential element of this.

Mr. Gibbs, I am drawing to a conclusion, but I have a question about one of our favorite subjects that we have talked about before. That is the taxpayers' bill of rights that became law and is now the law of this land. I am going to watch very carefully how this is implemented. I am going to research the regulations to see if the spirit in the letter of that law is carried out. The IRS has just now developed a form 911, in which taxpayers may request a TAO or a taxpayers assistance order, embodied in the taxpayers bill of rights. The Ombudsman has had the ability to issue these orders since the beginning of this year, 1989.

I would like to know if we have any idea thus far—I know it is very recent—of how many have been issued to date, and when can we expect the final recommendations coming down on the taxpayer assistance order? Do we have any indication?

Commissioner GIBBS. Let me, if I could, just comment briefly, then I will ask Mr. Holmes if he would to come to the microphone and give you information about your specific things. I kind of thought you might ask a question about this today. I rather suspect you will be watching our implementation of the Bill of Rights very closely. That does not come as a surprise.

I would like you to know that we recently completed a video tape that we are going to be sending to all of our employees. Mr. Murphy introduces it, and it involves a discussion with the Assistant Commissioner for Collection, the Assistant Commissioner for Examination, and the Taxpayer Ombudsman about what is in the bill, how we are going to respond, and how we expect our employees to respond.

Senator PRYOR. Now, is this the Taxpayer's Bill of rights?

Commissioner GIBBS. This is the Taxpayer's Bill of Rights. This is the video tape. It has your name on it if you would like to have it and see what we are saying.

Senator PRYOR. I sure would like to have it. I would like that.

Commissioner GIBBS. All right. A second thing is, this morning I signed an all-employee newsletter which sends out in writing, in case people do not see the video tapes, what the changes are, how we are going to respond, and how we are going to meet the spirit as well as the letter of the law. I will provide a copy for the record.

[The material appears in the appendix.]

As you know, our Publication 1 is out there, and our Form 911 is out there. I want you to know that I signed the regulations under Taxpayer Assistance Orders yesterday, and hope that they will be out within a very short period of time.

Mr. Chairman, we are moving forward. We are going to implement it. I will tell you this: we are doing everything we can possibly do within the resources that we have available to implement the Taxpayers' Bill of Rights. I want to emphasize, within the limit of the resources that we have available.

I hope, Mr. Chairman, you will understand the significance when I say within the limit of the resources we have available.

Now, what I would like to do is to ask the Taxpayer Ombudsman, if he would, to come and answer your specific questions.

Damon.

Senator PRYOR. Damon, before you answer that, let me ask you—no, go ahead, stand up, because I am going to ask you one that you can also give me an answer to. In the Internal Revenue Service Internal Memo—these are the IRS's words—it says, "Anticipated Impact: 'Minor.' It is not anticipated that a large number of TAO's will be required or issued."

Now, why does the IRS take that position? It does not sound like the taxpayer assistance orders are highly prioritized in the Internal Revenue Service. Do you have a comment?

Mr. HOLMES. Yes, sir; I do. The interpretation that is intended to be placed on the word "order" in the particular context that you are talking about—after the problem resolution officer has discussed the taxpayer's problem with the functional employee, the enforcement people, or whomever has received the thing—is that an order will be required in a sort of a compulsory way. That is, that the expectation—and I have figures here that I will show you in just a second that bear that out—is that the enforcement people will agree with the problem resolution officer that something needs to be done. So it will occur in the process that was set up by the bill of rights, but it will not usually require an order to get it done. It will be done cooperatively.

Since the beginning of January we have received and closed approximately 600—actually 616, I believe—cases. We have received a couple hundred more than that, but they have not been closed. Of the 616 cases that have been worked, only 4 of them have resulted in orders in the sense that there was a disagreement at the local level and the problem resolution officer said, "I would like it done my way."

Of the total, 447 of them were cases that justified our concern and were an opportunity to help the taxpayers. Those were done generally cooperatively or just by reviewing the facts, since in some cases the taxpayer raised an issue that the Service was working on

so that by the time we get the problem it has already been taken care of.

Another approximately 74, I think, were Problem Resolution Program or PRP cases, but did not have an aspect of significant hardship, which would require the extreme action of a quick response beyond normal PRP practice, which is maybe a couple of weeks. There were only 41 cases out of that 616 total that actually seemed to be inappropriate in terms of what I think the bill of rights had in mind; namely, that there was neither an aspect of significant hardship nor of the regular system failing to work. An additional 55 cases were sent—I think I have these numbers—I have not been looking at my notes—as regular problems to the functions that had them to work, without there being a PRP involvement after the review.

Senator PRYOR. Thank you.

Mr. HOLMES. That is an increase, Senator, in the rate we had before. We have been very careful to try to get the word out, both through our employees and the press. I would say a significant thing that the committee would be interested in, is that 398 of those cases, which we worked as taxpayer assistance orders, were identified by employees in the IRS reading incoming correspondence and looking at records. Those were not raised by taxpayers. Taxpayers, through their representatives or directly, raised only slightly more than 200 of those using the form or the phones.

Senator PRYOR. Thank you very much for the report. I do appreciate this. I am glad that you have done this. This may be your personal copy, Mr. Commissioner, and I certainly do not want to take that. But I will get a copy.

Commissioner GIBBS. Mr. Chairman, it is my gift to you. I will get another one.

Senator PRYOR. I did not mean to send it out there to snatch it away from you.

This has been a very good hearing this morning. It is on five areas of the Internal Revenue Service, each one of which could have probably justified a hearing date of its own. So we quickly hit some of the issues here—the five issues that we talked about in our opening statement.

I want to thank all of the witnesses this morning, from the Internal Revenue Service and from the General Accounting Office. I know full well that this subcommittee is going to do its very best to cooperate with your request Mr. Gibbs, and in cooperation with the General Accounting Office.

Once again, I applaud you for the joint effort that you have utilized in bringing these reports and recommendations together. And, Mr. Gibbs, I am going to miss you around here. I wish you well in private life and wonder if you have one final word that you would like to say.

Commissioner GIBBS. Mr. Chairman, I do.

One of the things that you have mentioned from time to time is the issue of what is going to happen when Larry Gibbs steps down as Commissioner. What is going to happen is that Michael J. Murphy, to my right, will become the Acting Commissioner until a new Commissioner is appointed. I can tell you that Mike and Charly and John, to my right, have composed our executive com-

mittee. And the answer is that the work that we have begun together will continue.

What I would like to do is to ask Mike, if he would, to give you a concluding comment to this hearing because Mike, in all likelihood, is going to be the person that you will be talking to as the Acting Commissioner at your next hearing.

Michael.

Senator PRYOR. Thank you, Mr. Gibbs.

Mr. Murphy.

Mr. MURPHY. Mr. Chairman, in addition to again repeating what you said about the joint effort between IRS and GAO, I would certainly like to compliment our friends from GAO for the job they did in working with us on this report. That can be something to be used for the future.

On the point about where IRS goes from here, we really do appreciate what you and Senator Heinz and Senator Bradley said about our Commissioner. We are going to miss him greatly ourselves. There are over 100,000 people who just feel terrible about Larry Gibbs leaving. We also change our loyalties quickly, and look forward to a new Commissioner and we appreciate your concern about one being appointed.

But I would like to assure you, Senator Pryor, that the entrenched bureaucracy is something that has become very, very closely allied to one Commissioner Gibbs, and the entrenched bureaucracy—that little pocket there—is starting to level off more and more. I would like to commit to you that the priorities that you have asked us to set are very much understood by this organization and we intend to carry them out, and we welcome the oversight that you provide, as well as GAO and other organizations.

So to you, Mr. Chairman, we have a great deal of gratitude and respect. We thank you for your leadership on the bill of rights and some of the other things that are taking place right now, and we hope that you are pleased with our commitment. And again, thank you for this hearing today.

Senator PRYOR. Mr. Murphy, thank you.

I think 2 years ago we had our first public hearing, Mr. Gibbs, and I think we talked about that very, very biblical tax collector in the Old Testament, Xacheus. Now 2 years later you have defied the presumption that all tax collectors are unpopular. You are leaving with, not only as I have said, the support of your colleagues in the Service, but also a great deal of admiration from the Senate and the House and your friends here.

Once again, we wish you well and we look forward to working with you.

Mr. Murphy, let me say that we are not going to forget our next phase of looking at penalties, and we are going to try to do something about this. We think there are too many penalties. We know that the IRS is concerned about this. I look forward to working with our House counterparts, Mr. Pickel and others, Chairman Pickel. They are interested in this matter. I look forward to cooperating with them.

With that, we will conclude the meeting. We wish you well, Mr. Gibbs, and your colleagues.

Thank you.

Commissioner GIBBS. Thank you, Mr. Chairman.

[Whereupon, at 11:50 a.m., the hearing was concluded.]

APPENDIX

ALPHABETICAL LIST AND MATERIAL SUBMITTED

MANAGING IRS: Actions Needed
To Assure Quality Service in the Future

Summary of Statement by
Gene L. Dodaro
Director, General Management Issues
U.S. General Accounting Office

A well managed IRS is critical to the functioning of our government and reinforcing public confidence in our tax system. GAO and IRS embarked on a joint effort to find solutions to the critical challenges facing IRS in managing its massive, decentralized operations. The ensuing report (GAO/GGD-89-1, October 14, 1988) made numerous recommendations to strengthen IRS management and help the Service better prepare for the future. IRS has pledged to implement all the recommended actions.

IRS needs to take actions centering on four major areas.

Improving Management of Information Technology - IRS' most pressing overall challenge in ensuring quality service to the public is to modernize its outdated and inefficient tax processing system. This will require a large investment, take several years to accomplish, and require application of state-of-the-art technology. Providing full-time leadership for the complex endeavor and raising the level of executives' technical expertise are paramount actions needed.

Strengthening Financial Systems - Although IRS will soon collect a trillion dollars annually in taxpayers' money, its accounting systems do not produce reliable information and have serious control problems. IRS is taking action to address these deficiencies, but it historically has had difficulty resolving these problems. Its efforts would be enhanced if it had a Chief Financial Officer who has sufficient authority to direct financial management activities and if its financial statements were audited annually.

Addressing Quality Concerns - IRS has begun a good effort to better orient its workforce to customer service. To know if it is making progress in improving the quality of its services IRS needs to develop better performance measures. Also, IRS must be better postured to cope with problems in attracting and retaining quality people to work for IRS. Non-competitive pay is a factor hindering IRS in this regard.

Improving Field Oversight - IRS must provide adequate resources and assign high priority to the implementation of its planned new approach to reviewing field operations. This process is essential to providing adequate oversight over field operations and assessing performance in achieving critical program objectives.

GAO believes that IRS has made a good start but needs to diligently implement these actions. GAO plans to monitor IRS' progress and provide status reports to Congress.

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss critical management challenges facing the Internal Revenue Service that must be addressed to assure high quality service to the Nation's taxpayers. I am accompanied today by Jennie S. Stathis, Director of Tax Policy and Administration Issues, General Government Division, James Watts, Associate Director of Central Financial Operations and Law Enforcement Systems Issues, Information Management and Technology Division, and Jeffrey C. Steinhoff, Director of Financial Management Systems Issues, Accounting and Financial Management Division.

It is vital that IRS effectively manage its massive operations and ensure uniform and fair implementation of an ever-changing set of complex tax laws. IRS routinely serves almost every household and business in the United States and soon will collect $1 trillion dollars annually in taxes. Moreover, its performance influences how Congress and the Administration make critical decisions to finance our government.

With this in mind, GAO and IRS embarked on a joint effort to find solutions to the major management issues confronting the Service, including replacing an aging computerized tax processing system and improving the quality of its services. The resulting report[1] made over 40 specific recommendations for improving IRS' management and helping it better prepare for the future. IRS fully supports these recommendations and has taken action to initiate a number of improvements; however, full implementation of many recommendations will require a sustained commitment from IRS. Support of the Department of the Treasury, the Office of Management and Budget, and Congress, also is important.

I want to focus my remarks today on IRS' four most critical management challenges. They are (1) improving the management of information technology, (2) strengthening financial management, (3) addressing service and workforce quality concerns, and (4) setting clear management direction and improving field oversight.

IMPROVING MANAGEMENT OF INFORMATION TECHNOLOGY

IRS' most critical need is to modernize its outdated computer-based tax processing system. Revamping this system, which is used to process hundreds of millions of taxpayer transactions each year, is central to improving service to taxpayers. IRS' present system is basically the same it started with almost 30 years ago; the input, storage and retrieval processes are paper-driven and labor-intensive.

This modernization is a massive undertaking, even compared to many of the large systems we hear about in government and industry today. It will require a large investment of public funds and take several years to plan and implement. IRS has

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[1] Managing IRS: Actions Needed to Assure Quality Service in the Future (GAO/GGD-89-1, Oct. 14, 1988).

preliminary design concepts, but the real work of the modernization is still ahead. As a next step, IRS needs to identify alternative designs, evaluate their costs, and select a final design. These actions will require complex decisions about state-of-the-art technology before IRS can proceed.

IRS' progress in meeting this critical challenge has been slow, due in part to lack of effective management direction and leadership changes within IRS and Treasury. One key problem had been the lack of a clearly designated leader in IRS for information resources management. IRS in late 1987 took positive steps to clarify the leadership structure for its overall management of information technology, including its information systems modernization efforts.

The Deputy Commissioner designated as IRS' information resources management focal point, however, has other significant responsibilities that preclude him from devoting full-time attention to this important area. As a result, IRS needs to seriously consider establishing another Deputy Commissioner whose sole responsibility is the management of technology. We believe that a separate Deputy Commissioner, who has extensive technical expertise, could provide concerted attention and direction necessary for the modernization. Success of the modernization effort is absolutely critical, and IRS needs to be in the strongest possible position to manage this endeavor.

IRS also needs to develop a strategy for raising the level of technical expertise of its managers. IRS executives have extensive managerial experience, but far less experience in managing the application of state-of-the-art technology. Additional training is needed if these managers are to make informed decisions and set the direction for the modernization.

In response to the management report, the Service is taking action to provide additional technical training to the senior management, and IRS expects to have an executive-level technical training program in place by July 1989. IRS top management needs to vigorously support this program.

In addition to strengthening training, IRS has initiated other actions to help put it in a better position to modernize its systems. For example, IRS has consolidated the management of critical telecommunication resources at the headquarters and regional office levels and is working to complete consolidation in the field. Additionally, IRS is making changes to improve its procurement of information technology. Progress in these areas needs to be monitored closely.

STRENGTHENING FINANCIAL MANAGEMENT

As the government's tax collector, IRS has unparalleled responsibility to maintain revenue accounting and administrative financial systems that are second to none. IRS accounts for 90 percent of the federal government's revenue and 60 percent of its delinquent receivables. Its visibility and contact with the public is equaled by very few federal agencies, and success in achieving its primary mission is highly dependent on voluntary compliance by the public. In this regard, taxpayers rightfully expect fair treatment by having records of their tax deposits, returns, and refunds accurately processed and maintained.

The GAO/IRS joint management review found that IRS' ability to satisfy its financial responsibilities and meet taxpayer expectations has been undermined by accounting processes with weak internal controls and old systems that produce inaccurate and untimely information. For example, on the revenue accounting side, a 1986 audit estimated that 721,000 tax deposits amounting

to $6.5 billion would result in erroneous bills, penalties, and refunds to businesses because IRS' control systems were unable to promptly identify and resolve errors. Internal control problems also preclude IRS from reliably accounting for billions of dollars of taxes owed to the government.

IRS' financial structure is comprised of systems that are not compatible and involve labor-intensive operations. The biggest challenge facing IRS in the financial management area is developing modern systems that will fill its needs and operate effectively through the year 2000 and beyond. IRS has recognized its financial systems problems and has initiated a set of actions to correct them. A key part of this effort will be the timely implementation of the recommendations contained in our October 1988 report. Of particular importance will be the establishment of a Chief Financial Officer (CFO) position.

A CFO could provide a key source of institutional continuity needed to provide sustained attention to the long-term financial management challenges facing IRS. The CFO should have enough institutional power to ensure that agency-wide financial management issues are dealt with efficiently and effectively. For example, the CFO should be responsible for establishing accounting standards for all systems and devising a financial reporting plan that includes a complete set of audited financial statements. Audited financial statements would impose a much needed reporting discipline on IRS' financial activities. IRS currently is studying the CFO issue, and needs to make implementation of this approach a high priority.

ADDRESSING SERVICE AND WORKFORCE QUALITY CONCERNS

IRS' mission translates into a large and growing annual work load. Few, if any, federal agencies have more customers to

serve. The quality of that service plays an important role in shaping taxpayers' views on how well the federal government functions.

A long tradition of solid IRS performance was shaken during the 1985 filing season when public confidence in the agency was reduced because of late refunds and incorrect taxpayer notices. These problems caused IRS management to give additional attention to improving the quality of its services to the public.

As a result, IRS began a major agencywide quality improvement effort, including providing training for all executives and managers and encouraging a cooperative effort with the National Treasury Employees Union. IRS also initiated a set of five new quality-oriented strategic initiatives, which include establishing program effectiveness measures, developing a greater concern for customers, identifying and reviewing barriers to quality, and developing a management information system to track progress in achieving quality goals and objectives.

These initiatives represent a solid beginning. Changing IRS' culture, however, from a production focus to a quality orientation represents a long-term management challenge. Continued employee involvement and support from IRS' leadership is essential in order to transform quality into a daily reality at the operating level.

Of particular importance will be the establishment and use of effective performance measures for all major IRS activities to assess whether or not it is making progress. For example, a 1988 study by Price Waterhouse recommended the use of nine new performance indicators to help manage the critical area of accounts receivable. These indicators included the average time

taken to collect receivables and the percentage of tax assessment actually collected. However, IRS does not have the needed data to compile all of these indicators. Formulating key indicators for all critical areas and collecting the necessary data will help ingrain quality values within the IRS workplace and provide a valuable framework for top management and congressional oversight of IRS activities.

IRS' ability to serve the public, like other federal operations, also hinges greatly on having quality people. Annually, thousands of IRS employees deal with millions of citizens, businesses, or their tax representatives on sensitive tax matters. For IRS to be effective, these activities must be carried out by quality employees possessing a variety of job skills. IRS must attract top graduates in the accounting, legal, and computer science fields. However, the Service has grown increasingly concerned about its capacity to attract and retain quality employees.

One important factor in attracting and retaining quality employees is competitive pay. GAO believes that federal pay is not competitive for many occupations because federal salary adjustments have not been keeping pace with comparable jobs in the private sector. GAO and IRS agree that the pay issue has contributed to IRS' workforce quality problems. Until the pay issue is resolved, IRS and other federal agencies will not be able to offer sufficiently competitive salaries to attract quality talent to many critical occupational series.

This need is especially acute at IRS. If the agency cannot attract highly qualified people, it will find itself at a disadvantage in dealing with lawyers and accountants from private firms. IRS has initiated a number of important efforts aimed at

strengthening its human resource capabilities. Many of these initiatives, however, are long-term in nature and will require a well-organized commitment on the part of IRS leadership. For example, IRS needs to collect better information on workforce quality to understand the full dimensions of the quality issue and to formulate effective solutions.

SETTING CLEAR MANAGEMENT DIRECTION AND IMPROVING FIELD OVERSIGHT

IRS must have an effective process for establishing a coherent strategic direction for the agency. Many challenges it confronts are interrelated and require long term action. Moreover, IRS needs to clearly communicate its priorities to people in its massive decentralized field structure and have a firm basis for measuring its performance.

IRS has initiated a new strategic management process to help set agencywide goals, establish mission priorities, guide budget decisions, and create a benchmark for measuring agency progress toward achieving objectives. This new process, which produces a five year strategic business plan, represents a sound conceptual approach, but certain implementation issues remain. The business planning process needs to be continued over the next several years in order for it to be firmly established as the agency's principal tool for setting management direction.

Another key implementation issue is the establishment of an adequate process to evaluate how well IRS field operations are achieving the objectives of the business plan. IRS is currently developing a new Business Review process for this purpose, and Internal Audit will also periodically evaluate the extent to which strategic objectives have been attained.

This new Business Review process, coupled with audited financial statements, has the potential to provide an effective annual nationwide assessment of IRS' performance in achieving critical

strategic business goals. This is essential for IRS top management and would be useful to Congress in exercising its oversight responsibilities. IRS currently is testing the Business Review aporoach and developing critical success factors to measure its performance. We are concerned, however, that development and agencywide implementation of Business Reviews will not proceed as quickly as it needs to, unless IRS changes its approach by providing full-time leadership for the effort.

IRS' ability to provide management direction also was enhanced by a 1987 reorganization intended to improve communication and strengthen decisionmaking. This reorganization was a very positive change, particularly placing the Regional Commissioners under the Deputy Commissioner for Operations. To ensure that the 1987 changes continue to have managers' support and confidence, IRS and GAO will be evaluating the reorganization to ascertain to what extent it has accomplished its goals and whether refinements are needed. As we discussed earlier, additional modifications are desirable in the information technology and financial management areas.

In closing, we would like to commend IRS officials for their willingness to take a candid look at IRS management to identify needed improvements and for their very cooperative approach in working with us. The recommendations set forth in the management report provide a blueprint for the future to help assure quality service to the public and a well managed IRS. The key now is to ensure that IRS effectively and diligently implements the recommendations over the coming years. In this regard, we intend to monitor IRS' progress, and continued Congressional oversight will be important. We commend the Subcommittee for holding these hearings and providing a framework for Congress and the IRS to work together to improve IRS' operations and thus better serve the American taxpayer.

TESTIMONY OF
LAWRENCE B. GIBBS
COMMISSIONER OF INTERNAL REVENUE

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

I APPRECIATE THE OPPORTUNITY TO APPEAR HERE TODAY TO DISCUSS THE JOINT IRS/GAO REVIEW WHICH IS REFLECTED IN GAO'S OCTOBER, 1988 REPORT ON MANAGING IRS: ACTIONS NEEDED TO ASSURE QUALITY SERVICE IN THE FUTURE.

AS YOU KNOW, THIS REPORT WAS A COOPERATIVE EFFORT BETWEEN GAO AND IRS, WHICH BEGAN THREE YEARS AGO. I BELIEVE THE REPORT ACCURATELY PORTRAYS BOTH OUR RECENT SUCCESSES AND THE CHALLENGES WE FACE IN PROVIDING QUALITY TAX ADMINISTRATION IN THE FUTURE.

MY TESTIMONY TODAY WILL OUTLINE THE MAJOR PROGRAMS IRS HAS IN PLACE TO ADDRESS AREAS OF CONCERN NOTED IN THE REPORT. IT WILL ALSO DESCRIBE THE PLANNING AND QUALITY INITIATIVES UNDERWAY THAT, I BELIEVE, WILL ASSURE FAIR AND EFFECTIVE TAX ADMINISTRATION IN THE FUTURE.

WITH ME TODAY ARE THE SENIOR DEPUTY COMMISSIONER MIKE MURPHY, THE DEPUTY COMMISSIONER FOR OPERATIONS CHARLY BRENNAN, AND THE DEPUTY COMMISSIONER FOR PLANNING AND RESOURCES JOHN WEDICK. ALSO HERE ARE THE TAXPAYER OMBUDSMAN DAMON HOLMES, THE NEWLY-APPOINTED ASSISTANT TO THE COMMISSIONER (QUALITY) AL KOLAK, AND OTHER TOP IRS OFFICIALS WHO ARE AVAILABLE AS NEEDED TO DISCUSS THEIR RESPECTIVE PROGRAMS.

BUILDING ON A SUCCESSFUL FOUNDATION

THE GAO REPORT NOTES THAT IRS OPERATES IN A "DYNAMIC" ENVIRONMENT. LAST YEAR IRS PROCESSED 194 MILLION TAX RETURNS AND NEARLY A BILLION INFORMATION RETURNS, AND WE PROJECT THE NUMBER OF TAX RETURNS FILED TO INCREASE TO 208 MILLION IN 1990 AND TO 233 MILLION IN 1995. LAST YEAR IRS ANSWERED NEARLY 39

MILLION TELEPHONE INQUIRIES, HANDLED ALMOST 60 MILLION TAXPAYER CONTACTS IN TOTAL, AND WE EXPECT THE NUMBER OF CONTACTS TO CONTINUE TO INCREASE IN THE FUTURE. LAST YEAR IRS MANAGED ONE OF THE LARGEST COMPUTER SYSTEMS IN THE WORLD IN COLLECTING AND ACCOUNTING FOR OVER $935 BILLION OF GROSS TAX REVENUES, AND THIS YEAR WE ANTICIPATE THAT GROSS TAX REVENUES WILL TOP $1 TRILLION FOR THE FIRST TIME IN OUR NATION'S HISTORY. IT IS IMPORTANT FOR US TO DEMONSTRATE TO THE CONGRESS AND TO ALL TAXPAYERS THAT WE ARE ABLE TO EFFECTIVELY MANAGE THESE OPERATIONS. WE THEREFORE WELCOME THE REVIEW BY GAO AND BY THIS COMMITTEE.

WHEN I CAME TO THE AGENCY IN 1986, IRS HAD ALREADY SUCCESSFULLY COMPLETED ITS 1986 FILING SEASON, HAD INITIATED A NUMBER OF QUALITY IMPROVEMENT PROGRAMS, AND WAS ANTICIPATING ENACTMENT OF THE MOST COMPREHENSIVE TAX CHANGE IN 30 YEARS -- THE TAX REFORM ACT OF 1986. I NOTE THESE TO POINT OUT THAT IRS HAS BEEN, AND I AM SURE WILL CONTINUE TO BE, A WELL-MANAGED AGENCY. WE ARE NOT AFRAID TO EXAMINE OURSELF OR ADMIT OUR DEFICIENCIES, AS EVIDENCED BY THIS JOINT REVIEW WITH GAO. THE INITIATIVES THAT WERE UNDERWAY IN 1986 AND THOSE WHICH WE HAVE BEGUN SINCE HAVE IMPROVED, AND WILL CONTINUE TO IMPROVE, OUR OPERATIONS.

SOME RECENT IRS ACTIONS NOTED BY GAO SUPPORT MY CONFIDENCE IN IRS' ABILITY TO CONTINUE ITS RECENT SUCCESSES IN THE FACE OF AN EVER-GROWING WORKLOAD. THESE INCLUDE:

1. ESTABLISHING AN EFFECTIVE STRATEGIC BUSINESS PLANNING PROCESS WHICH PROVIDES A LONG-TERM STRATEGY FOR MEETING THE CHALLENGES FACING OUR AGENCY.
2. REORGANIZING THE TOP-LEVEL MANAGEMENT STRUCTURE OF OUR AGENCY TO ACHIEVE GREATER ACCOUNTABILITY AND TO IMPROVE INTERNAL COMMUNICATIONS.
3. IMPLEMENTING A MANAGEMENT/UNION AGREEMENT TO WORK JOINTLY ON INITIATIVES TO IMPROVE THE QUALITY OF OUR PRODUCTS AND SERVICES.

4. Proceeding in the redesign of our tax information systems to provide better customer service and increase our efficiency. This effort is now cited as an Administration priority.

The results over the past several years are evidence that these efforts are already paying dividends. Let me give you some examples.

Certainly one of IRS' major recent accomplishments was the successful implementation of the Tax Reform Act of 1986. Easily the most sweeping change to the Tax Code in more than 30 years, the Act was implemented over the 1987 and 1988 filing seasons without major problems. The success of this effort was confirmed in a November 1987 report prepared for IRS by an independent consulting firm. Also, GAO in its November, 1988 Report entitled, "Effective Implementation of the Tax Reform Act Led to Uneventful 1988 Filing Season", concluded that "IRS did a good job implementing the Tax Reform Act."

Similarly, implementation of the Taxpayer Bill of Rights is on schedule and proceeding smoothly. If the favorable receptions accorded our new Publication 1, "Your Rights As A Taxpayer", and our Form 911 for hardship relief are any indication, we are capturing both the letter and the spirit of the new law in our actions.

Thirdly, we are very encouraged to see that voluntary compliance levels for individuals are rising. In March 1988, we issued a new "Tax Gap" report, Gross Tax Gap Estimates and Projections for 1973-1992. That study, which updated our 1983 study, showed that the voluntary compliance rate for individuals was expected to further improve from 83.5% in 1987 to 84.9% in 1992. Expanded information reporting, fewer and more limited deductions and lower marginal tax rates contained in recent legislation have contributed to this increase.

FOURTHLY, I WOULD NOTE THE SUCCESSFUL FILING SEASONS IN 1987 AND 1988 AND OUR VERY DETAILED AND COMPREHENSIVE PLANS TO PREPARE FOR 1989. TO ASSURE THAT WE WERE COMPLETELY PREPARED, WE APPOINTED AN EXECUTIVE GROUP TO CONDUCT ON-SITE REVIEWS OF EACH OPERATION TO ASSESS ITS READINESS FOR THE FILING SEASON. THESE EFFORTS STARTED ALMOST A YEAR IN ADVANCE OF EACH FILING SEASON, AND WERE CONTINUALLY UPDATED TO ACCOMMODATE TAX LAW CHANGES ENACTED LATE IN THE YEAR. OUR FILING SEASON REPORTS TO DATE INDICATE THAT THE 1989 FILING SEASON IS GOING SMOOTHLY FOR TAXPAYERS AND THE IRS.

OVER THE PAST THREE YEARS, A MAJOR REALIGNMENT OF IRS RESOURCES HAS TAKEN PLACE WHICH STRENGTHENED OUR FOCUS ON EDUCATION AND ASSISTANCE TO TAXPAYERS WHO ARE TRYING TO COMPLY WITH THEIR TAX ORLIGATIONS. AS YOU KNOW, THIS HAS BEEN ONE OF MY MAJOR GOALS. WE HAVE REALIGNED OUR BUDGET RESOURCES FROM A RATIO OF 70% COMPLIANCE - 30% TAXPAYER SERVICE TO A NEW RATIO OF 60% COMPLIANCE - 40% TAXPAYER SERVICE. IN ABSOLUTE TERMS, THIS AMOUNTS TO A SHIFT OF SOME $500 MILLION ANNUALLY INTO SERVICE-RELATED ACTIVITIES SUCH AS TAXPAYER TELEPHONE INQUIRIES, TAXPAYER CORRESPONDENCE, AND RETURNS PROCESSING . I DON'T MEAN TO DOWNPLAY IN ANY WAY OUR COMMITMENT TO ENSURING COMPLIANCE BY THOSE WHO HAVE FAILED TO PAY THEIR FAIR SHARE OF TAX. THOSE COMPLIANCE PROGRAMS HAVE BEEN AND WILL CONTINUE TO BE ONE OF OUR MAJOR AREAS OF RESPONSIBILITY. BUT WE ALSO ARE LOOKING FOR OTHER WAYS TO ENSURE COMPLIANCE, AND I BELIEVE EDUCATION AND ASSISTANCE TO TAXPAYERS CONTRIBUTES DIRECTLY TO IMPROVED COMPLIANCE, EVEN THOUGH THAT CONTRIBUTION IS OFTEN DIFFICULT TO MEASURE IN EMPIRICAL TERMS. THE NEW RATIO OF SERVICE TO COMPLIANCE STRIKES A MORE APPROPRIATE BALANCE FOR IRS IN THE ENVIRONMENT OF THE LATE 1980'S, AND MUST BE MAINTAINED FOR US TO CONTINUE MANY OF THE QUALITY INITIATIVES UNDERTAKEN TO DATE.

FINALLY, AND PERHAPS MOST IMPORTANT, OUR INITIATIVES IN QUALITY IMPROVEMENT AND ENHANCED CUSTOMER SERVICE OVER THE PAST THREE YEARS HAVE PAID DIVIDENDS NOW AND LAID THE GROUNDWORK FOR

EVEN MORE IMPROVEMENT IN THE FUTURE. THE THEME OF QUALITY CUSTOMER SERVICE IS CENTRAL TO ALL THE ACCOMPLISHMENTS I JUST MENTIONED, AND IS BECOMING AN INTEGRAL PART OF IRS' ONGOING PLANNING AND OPERATING ACTIVITIES. SEVERAL IRS QUALITY IMPROVEMENT PROJECTS HAVE BEEN SINGLED OUT FOR AWARDS AND RELATED RECOGNITION BY OMB AND OTHER ORGANIZATIONS CONCERNED WITH QUALITY, AND THIS HAS BEEN VERY GRATIFYING TO ALL OF US. BUT AS WE SEE IT, QUALITY IS AN ONGOING PROCESS, NOT A GOAL OR A SPECIFIC PROJECT TO BE FINISHED AND FORGOTTEN. KNOWING THAT THE QUALITY IMPROVEMENT PROCESS HAS STRONG SUPPORT FROM MANAGEMENT AND EMPLOYEES THROUGHOUT THE AGENCY, I EXPECT IT TO PAY DIVIDENDS LONG INTO THE FUTURE.

I DO NOT SUGGEST THAT THERE IS NOT ROOM FOR IMPROVEMENT NOR THAT IN ALL AREAS WE ARE WHERE WE WANT TO BE. BUT I AM PLEASED WITH THE START AND THE PROGRESS THAT WE HAVE MADE.

GAO/IRS MANAGEMENT REVIEW

AS NOTED EARLIER, GAO AND IRS AGREED IN THE SPRING OF 1986 TO UNDERTAKE A JOINT GENERAL MANAGEMENT REVIEW AT IRS. FOR US, THE MOST IMPORTANT FACTOR IN GAO'S APPROACH TO A MANAGEMENT REVIEW WAS THEIR INTENT TO SERVE NOT AS AUDITORS, BUT AS MANAGEMENT CONSULTANTS, ADVISING US ON HOW IMPROVEMENTS IN MANAGEMENT PROCESSES, SYSTEMS, AND STRUCTURE COULD ENHANCE AN AGENCY'S ABILITY TO ACCOMPLISH ITS MISSION. WE ALSO WELCOMED THE IDEA OF USING EXTERNAL CONSULTANTS -- PUBLIC AND PRIVATE SECTOR EXECUTIVES WITH EXPERIENCE IN MANAGING LARGE GOVERNMENT AGENCIES OR OTHER SIMILAR ORGANIZATIONS -- TO INFUSE A DIFFERENT, AND SOMETIMES FRESHER, PERSPECTIVE INTO THE PROCESS.

AN AGREEMENT WAS DRAWN UP AND SIGNED BY BOTH AGENCIES WHICH SET FORTH THE GENERAL GUIDELINES UNDER WHICH THE JOINT REVIEW WOULD BE CONDUCTED AND REPORTED. IRS HAD A TWO-LEVEL APPROACH TO ENSURE THAT TOP MANAGEMENT WOULD BE INVOLVED IN THE PROCESS. FIRST, THE COMMISSIONER, THE DEPUTY COMMISSIONERS, AND OTHER SENIOR MANAGEMENT OFFICIALS WERE INVOLVED TO EMPHASIZE THE TOP PRIORITY NATURE OF THIS EFFORT. SECOND, AN EXECUTIVE-LEVEL WORKING GROUP CHAIRED BY JOHN WEDICK, THE DEPUTY COMMISSIONER

FOR PLANNING AND RESOURCES, AND COMPOSED OF A REGIONAL COMMISSIONER, A DISTRICT DIRECTOR, A SERVICE CENTER DIRECTOR, AND AN ASSISTANT COMMISSIONER MONITORED AND COORDINATED THE REVIEW WITHIN IRS. IN ADDITION TO THE INVOLVEMENT OF GAO AND IRS EXECUTIVES AND STAFF, A DISTINGUISHED PANEL OF EXTERNAL CONSULTANTS, BOTH PRIVATE AND PUBLIC, WITH EXPERIENCE IN MANAGING LARGE ORGANIZATIONS WAS ESTABLISHED TO PROVIDE ADVICE THROUGHOUT THE COURSE OF THE REVIEW. THIS PANEL WAS JOINTLY SELECTED AND INCLUDED INDIVIDUALS WITH EXPERIENCE IN TAX ADMINISTRATION, INFORMATION TECHNOLOGY AND MANAGEMENT.

THE GOAL OF BOTH IRS AND GAO WAS TO HAVE A TRULY JOINT EFFORT. IRS ASSURED THAT IRS EXECUTIVES, MANAGERS AND EMPLOYEES WERE WILLING TO SHARE INFORMATION WITH GAO'S REVIEW STAFF. WE PARTICIPATED IN THE DEVELOPMENT OF THE QUESTIONNAIRE THAT WAS SENT TO EXECUTIVES AND LINE EMPLOYEES AND HELPED CONDUCT THE STRUCTURED INTERVIEWS. WE ALSO REVIEWED ALL DRAFTS OF THE REPORT AND WORKED CLOSELY WITH GAO ON THE PREPARATION OF THE FINAL REPORT.

THE OBJECTIVE OF THE MANAGEMENT REVIEW WAS TO EXAMINE MANAGEMENT ISSUES RELATING TO IRS' (1) PLANNING AND BUDGETING PROCESSES, (2) INFORMATION RESOURCES MANAGEMENT, (3) HUMAN RESOURCES MANAGEMENT, (4) FINANCIAL MANAGEMENT, (5) PRODUCTIVITY MANAGEMENT, (6) AND PROGRAM MANAGEMENT EFFORTS TO STRENGTHEN VOLUNTARY COMPLIANCE. BECAUSE OF THE CRITICAL NATURE OF THESE ISSUES, IMPROVEMENTS HAVE ALREADY BEEN EFFECTED OR ARE WELL UNDERWAY. FOR EXAMPLE, THE NEW STRATEGIC BUSINESS PLAN WAS USED TO PREPARE THE FY1990 BUDGET SUBMITTED TO TREASURY IN JULY, 1988. TELECOMMUNICATIONS FUNCTIONS WERE CONSOLIDATED UNDER THE ASSISTANT COMMISSIONER (COMPUTER SERVICES) EFFECTIVE OCTOBER 1, 1988. THE PRODUCTIVITY THROUGH QUALITY INNOVATION ENHANCEMENT PROGRAM WAS STRENGTHENED THROUGH AN ACTIVE PUBLICITY CAMPAIGN. INTERNAL AUDIT STAFFING RECEIVED THE FIRST OF SEVERAL ANNUAL INCREASES DESIGNED TO FACILITATE BETTER INTERNAL PROGRAM REVIEWS. DEVELOPMENT OF A BUSINESS REVIEW PROCESS TO REPLACE THE NATIONAL OFFICE REVIEW PROGRAM IS

UNDERWAY, AND A BUSINESS REVIEW EXECUTIVE HAS BEEN NAMED. THESE ACTIONS ARE INDICATIVE OF THE COMMITMENT BY THE IRS TO IMPLEMENT THE IMPROVEMENTS CALLED FOR IN THE GAO REPORT.

WE FULLY SUPPORT THE RECOMMENDATIONS CONTAINED IN THE FINAL REPORT AND SUPPORT ALL EFFORTS TO MOVE AHEAD ON IMPLEMENTING THOSE RECOMMENDATIONS NOT ALREADY COMPLETED. MANY OF THE RECOMMENDATIONS WILL BE COMPLETED THIS FISCAL YEAR. THOSE THAT WILL TAKE LONGER ARE IDENTIFIED AND WILL BE CLOSELY MONITORED TO COMPLETION. IN ADDITION, WE ARE KEEPING GAO INFORMED OF OUR PROGRESS ON A REGULAR BASIS TO ASSIST THEM WITH THEIR SCHEDULED FOLLOW-UP REVIEWS OVER THE NEXT TWO YEARS.

QUALITY SERVICE TO THE PUBLIC

THE INTERNAL REVENUE SERVICE AGREES WITH GAO ON THE CHALLENGES THAT MUST BE MET TO PROVIDE QUALITY CUSTOMER SERVICE TO AMERICAN TAXPAYERS. BY SOLICITING THE SUPPORT OF MANAGEMENT AND EMPLOYEES THROUGHOUT THE IRS AND BY RELYING ON THE ADVICE OF OUTSIDE EXPERTS IN THE FIELD, WE BELIEVE WE HAVE TAKEN POSITIVE STEPS TO MAKE QUALITY SERVICE AN INTEGRAL PART OF THE CULTURE AT IRS.

MANAGEMENT COMMITMENT AND EMPLOYEE INVOLVEMENT ARE THE CORNERSTONES OF OUR QUALITY PROCESS. ON OCTOBER 27, 1987, IRS AND THE NATIONAL TREASURY EMPLOYEES UNION (NTEU) ENTERED INTO AN HISTORIC COOPERATIVE AGREEMENT ESTABLISHING THE NEW IRS/NTEU JOINT QUALITY IMPROVEMENT PROCESS, WHICH MADE NTEU AN EQUAL PARTNER IN ALL QUALITY IMPROVEMENT EFFORTS AT IRS.

WE HAVE USED THE TECHNIQUES OF QUALITY PLANNING, QUALITY CONTROL AND QUALITY IMPROVEMENT RECOMMENDED TO US BY DR. JOSEPH M. JURAN, A NOTED QUALITY EXPERT. THROUGHOUT OUR ORGANIZATION, EXECUTIVES AND REPRESENTATIVES OF THE UNION ARE DIRECTLY INVOLVED IN QUALITY IMPROVEMENT TRAINING. THEY ALSO ARE MEMBERS OF QUALITY COUNCILS WHICH MEET REGULARLY TO ASSIGN QUALITY IMPROVEMENT TEAMS TO ADDRESS SYSTEMIC PROBLEMS. THERE PRESENTLY ARE OVER 500 TEAMS IN EXISTENCE. MANAGERS AND EMPLOYEES WORK TOGETHER ON THESE TEAMS, WHICH MEET FREQUENTLY

TO USE PROVEN TECHNIQUES TO IDENTIFY ROOT CAUSES OF PROBLEMS AND PROPOSE APPROPRIATE SOLUTIONS. THE CROSS-FUNCTIONAL NATURE OF MANY OF THESE QUALITY COUNCILS AND TEAMS HAS HELPED PROMOTE BETTER UNDERSTANDING AND COMMUNICATION THROUGHOUT IRS.

AS NOTED IN THE GAO REPORT, WE HAVE NOW BEGUN TO DO QUALITY PLANNING. OUR COMMITMENT TO QUALITY SERVICE STRATEGIC INITIATIVES, BEGUN IN JULY 1987, INTEGRATED OUR PLANS FOR QUALITY PLANNING WITHIN OUR STRATEGIC MANAGEMENT SYSTEM. THE FIVE QUALITY ORIENTED STRATEGIC INITIATIVES INCLUDE ESTABLISHING PROGRAM EFFECTIVENESS MEASURES, MEETING CUSTOMER NEEDS, ELIMINATING BARRIERS TO QUALITY, INSTILLING A COMMITMENT TO QUALITY THROUGHOUT THE IRS, AND ADAPTING OUR MANAGEMENT INFORMATION SYSTEMS TO TRACK OUR PROGRESS IN ACHIEVING OUR QUALITY GOALS. THESE INITIATIVES ARE PRODUCING REPORTS WITH RECOMMENDATIONS ON HOW TO ACCOMPLISH THESE OBJECTIVES.

LIKE PRIVATE INDUSTRY, IRS HAS FOUND THAT THERE ARE CONSIDERABLE START-UP COSTS INVOLVED IN AN EMPHASIS ON QUALITY AND CUSTOMER SERVICE. THESE INCLUDE MANY TRAINING COSTS AND START-UP COSTS FOR QUALITY IMPROVEMENT TEAMS TO FUNCTION EFFECTIVELY TOGETHER AFTER TRAINING.

BUT PRIVATE INDUSTRY ALSO TELLS US THAT, IN THE LONG TERM, THESE START-UP COSTS SHOW VERY REAL BENEFITS FOR THE ORGANIZATION. SOME OF THESE BENEFITS HAVE ALREADY BEEN EVIDENCED IN THE SUCCESSES OF OUR INDIVIDUAL PROJECTS. TWO IRS SERVICE CENTERS THAT HAVE MADE CONCERTED QUALITY IMPROVEMENT EFFORTS AND TWO OTHER MAJOR QUALITY IMPROVEMENT PROJECTS HAVE BEEN RECOGNIZED BY OMB AS MODELS FOR OTHER GOVERNMENT AGENCIES.

MR. CHAIRMAN, LET ME USE JUST ONE EXAMPLE TO SHOW WHAT WE MEAN WHEN WE SPEAK OF THE BENEFITS OF QUALITY IMPROVEMENT. OUR FRESNO SERVICE CENTER, WHICH WAS ONE OF THE SERVICE CENTERS SELECTED BY OMB AS A PROTOTYPE ORGANIZATION, IS ONE OF TEN PROCESSING CENTERS NATIONWIDE, EMPLOYING MORE THAN 6,000 PEOPLE DURING THE PEAK FILING SEASON, AND HANDLING MORE THAN 32 MILLION FEDERAL TAX RETURNS, RELATED DOCUMENTS, PAYMENTS AND CORRESPONDENCE FROM TAXPAYERS LIVING IN HAWAII AND MOST OF

CALIFORNIA. LAST YEAR THE CENTER PROCESSED MORE THAN 11.1 MILLION INDIVIDUAL 1988 TAX RETURNS, OVER 7.4 MILLION OF THOSE FROM INDIVIDUALS ENTITLED TO REFUNDS TOTALING NEARLY $7.4 BILLION.

AS A RESULT OF QUALITY IMPROVEMENT AND RELATED PRODUCTIVITY EFFORTS AT FRESNO:

- THE CENTER ENABLED 29,000 BUSINESSES TO CALL AND INSTANTLY RECEIVE THEIR EMPLOYER IDENTIFICATION NUMBERS. THIS WAS AN INCREASE OF ALMOST 300% OVER THE PREVIOUS YEAR
- 13,000 TAXPAYERS HAD THEIR QUESTIONS IMMEDIATELY ANSWERED BY EMPLOYEES IN THE TELEPHONE CONTACT UNIT. THESE WERE TAXPAYERS WHO, IN PREVIOUS YEARS, WOULD HAVE BEEN TOLD TO PUT THEIR QUESTIONS IN WRITING AND WAIT SEVERAL WEEKS FOR A RESPONSE
- PROBLEM RESOLUTION CASES WERE RESOLVED IN AN AVERAGE OF 11 DAYS, ABOUT HALF THE TIME IT TOOK THE YEAR BEFORE. THE CENTER HAS ALSO BECOME MORE ADEPT AT IDENTIFYING THESE CASES, AND AS A RESULT DISTRICT OFFICES ARE RECEIVING FEWER PROBLEM RESOLUTION PROGRAM CASES

THESE IMPROVEMENTS WERE ACCOMPLISHED WHILE TWO OTHER MAJOR EVENTS WERE TAKING PLACE AT THE CENTER: IMPLEMENTING THE TAX REFORM ACT OF 1986, WHICH IMPACTED EVERY FACET OF THE CENTER'S OPERATION, AND PILOTING THE START OF A MAJOR UPGRADED COMPUTER SYSTEM. IT WOULD NOT HAVE BEEN POSSIBLE TO SUCCESSFULLY HANDLE SO MANY CHANGES CONCURRENTLY WITHOUT THE FUNDAMENTAL CULTURAL CHANGE WHICH IS BEING ACCOMPLISHED AT IRS THROUGH THE QUALITY PROCESS.

IMPROVING SERVICES

MR. CHAIRMAN, SINCE WE HAVE BEEN TALKING ABOUT PROVIDING QUALITY SERVICE TO THE PUBLIC, I WOULD LIKE TO EXPLAIN HOW WE ARE ATTEMPTING TO IMPROVE SERVICES IN THE AREAS OF TAXPAYER CORRESPONDENCE, TAXPAYER SERVICE, AND THE PROBLEM RESOLUTION PROGRAM. ALL OF THESE HAVE BEEN THE SUBJECT OF RECENT GAO REPORTS.

TAXPAYER CORRESPONDENCE

TAXPAYER CORRESPONDENCE RECEIVED AT IRS SERVICE CENTERS IS PRIMARILY HANDLED BY TAX EXAMINERS IN THE ADJUSTMENTS AND CORRESPONDENCE BRANCH AT EACH CENTER. THIS BRANCH HANDLES A HIGH VOLUME OF CORRESPONDENCE AND IS VERY IMPORTANT TO TAXPAYERS BECAUSE IT RECORDS PAYMENTS, CORRECTS ERRORS, AND MAKES OTHER ADJUSTMENTS TO THEIR ACCOUNTS. IN 1988, THIS SERVICE CENTER OPERATION NATIONWIDE HANDLED NEARLY 11.6 MILLION CASES.

RECENT GAO AND IRS STUDIES HAVE IDENTIFIED DEFICIENCIES IN THE QUALITY OF ASSISTANCE BEING PROVIDED TO TAXPAYERS WHO WRITE TO THE SERVICE CENTERS TO RESOLVE THEIR ACCOUNT QUESTIONS. THESE STUDIES HAVE PROVEN CONSTRUCTIVE, AND I WOULD LIKE TO DISCUSS WITH YOU THE STATUS OF OUR EFFORTS TO IMPROVE THIS OPERATION.

PERHAPS THE MOST SIGNIFICANT ACTION OVER THE PAST SEVERAL YEARS TO IMPROVE THE QUALITY OF OUR CORRESPONDENCE WAS THE DEVELOPMENT OF A PROGRAM ANALYSIS SYSTEM WHICH BECAME OPERATIONAL IN JANUARY, 1988. THIS SYSTEM COLLECTS DATA TO MEASURE THE EFFECTIVENESS OF VARIOUS PROGRAMS IN OUR SERVICE CENTERS. IT IDENTIFIES THE ERRORS, ANALYZES THE CAUSES, RECOMMENDS CORRECTIVE ACTIONS, AND FOLLOWS UP TO INSURE THAT THESE ACTIONS HAVE BEEN TAKEN. IT IS AN IMPORTANT MANAGEMENT TOOL, PROVIDING ERROR AND TREND ANALYSES OF WORKLOAD. WE BELIEVE THAT THIS SYSTEM WILL ENABLE US TO TARGET AND MEASURE THE EFFECTIVENESS OF OUR EFFORTS TO IMPROVE THE QUALITY OF OUR RESPONSES TO TAXPAYER CORRESPONDENCE AND REQUESTS FOR ADJUSTMENTS.

EQUALLY IMPORTANT IS OUR ADJUSTMENTS RECEIPTS AND TIMELINESS STUDY CALLED "ARTS", WHICH WAS INITIATED IN AUGUST, 1986. USING OUR NEW QUALITY IMPROVEMENT PROCESS, THIS STUDY WAS INITIATED TO IDENTIFY IMPEDIMENTS TO TIMELY PROCESSING OF TAXPAYER INQUIRIES AND WAYS IN WHICH WE COULD REDUCE OUR CORRESPONDENCE INVENTORIES.

MANY OF THE ISSUES ADDRESSED IN THE ARTS REPORT WERE ALSO

IDENTIFIED IN LAST YEAR'S GAO REPORT. THE ARTS REPORT MADE ALMOST 150 RECOMMENDATIONS, MANY OF WHICH HAVE BEEN IMPLEMENTED. GAO REVIEWED THE STUDY'S RECOMMENDATIONS AND CONCLUDED THAT, WHEN IMPLEMENTED, THEY WILL IMPROVE THE QUALITY OF TAXPAYER CORRESPONDENCE.

A KEY IMPROVEMENT FROM THIS STUDY WAS THE DEVELOPMENT OF A MANAGERS' HANDBOOK, WHICH WAS COMPLETED IN OCTOBER, 1988. THE HANDBOOK SPELLS OUT IN DETAIL THE DUTIES OF EACH MANAGEMENT LEVEL AND EMPHASIZES THE REVIEWS NECESSARY TO ASSURE ACCURATE RESPONSES. IT WAS DEVELOPED BY A GROUP OF EXPERIENCED MANAGERS, AND ALL APPROPRIATE FIELD MANAGERS HAVE BEEN TRAINED ON ITS USE AND APPLICATION.

ANOTHER CHANGE WAS AIMED AT REDUCING THE NUMBER OF ADJUSTMENT CASES WHERE TAXPAYERS HAVE TO CONTACT US MORE THAN ONCE. BASED ON AN ANALYSIS OF A SAMPLE OF 21,000 CLOSED ADJUSTMENT CASES, IT APPEARS THAT THE CORRECTIVE ACTIONS TAKING PLACE SHOULD PREVENT A REOCCURANCE OF THE VAST MAJORITY OF CASES SIMILAR TO THESE.

THERE ARE ALSO SYSTEM CHANGES UNDERWAY. FOR EXAMPLE, GAO FOUND THAT THE CORRESPONDENCE SYSTEM WHICH OUR EMPLOYEES USE MAKES IT DIFFICULT FOR THEM TO TAILOR RESPONSES TO INDIVIDUAL TAXPAYERS. IN ADDITION, TAX EXAMINERS ARE UNABLE TO VIEW THE LETTERS THEY HAVE COMPOSED. WE ARE CURRENTLY DEVELOPING STATE-OF-THE-ART CORRESPONDENCE SOFTWARE THAT WILL ADDRESS BOTH THESE PROBLEMS. ASSUMING AVAILABLE FUNDING, THE NEW SYSTEM IS TO BE TESTED THIS YEAR AND IMPLEMENTED NATIONWIDE NEXT YEAR.

IRS' COMMITMENT TO QUALITY IS REFLECTED IN THESE AND OTHER EFFORTS TO RESPOND TO GAO'S REVIEWS AND OUR OWN STUDIES ON TAXPAYER CORRESPONDENCE. THE PROCESS IS ONGOING BECAUSE WE STILL HAVE SUBSTANTIAL ROOM FOR IMPROVEMENT, AND I AM CONFIDENT THAT THESE SERVICES TO TAXPAYERS WILL CONTINUE TO IMPROVE.

TAXPAYER SERVICE

TAXPAYER SERVICE IS ANOTHER AREA WE ARE CONTINUING TO IMPROVE. SINCE 1986, WE HAVE INCREASED THE STAFFING, THE

NUMBER OF TOLL-FREE LINES, AND THE AMOUNT OF TRAINING OUR ASSISTORS RECEIVE. WE HAVE ALSO CHANGED THE MIX OF EMPLOYEES WHO ASSIST TAXPAYERS ON TOLL-FREE LINES. WE HAVE MORE FULL-TIME ASSISTORS IN PLACE OF SEASONAL EMPLOYEES WHO WORKED ONLY DURING THE FILING SEASON.

BESIDES INCREASING STAFFING, WE EMPLOY A VARIETY OF NEW TECHNOLOGIES TO AUTOMATE BASIC SERVICES. THESE INCLUDED OUR TELETAX SYSTEM, A SERIES OF PRE-RECORDED MESSAGES TO RESPOND TO NON-COMPLEX TECHNICAL INQUIRIES AND TO PROVIDE AUTOMATED RESPONSES TO REFUND INQUIRIES. A SYSTEM HAS ALSO BEEN ESTABLISHED TO ENABLE THE PUBLIC TO CALL CENTRALIZED FORMS DISTRIBUTION SITES TO ORDER TAX FORMS. COLLECTIVELY, THESE INITIATIVES HAVE RESULTED IN A SHIFT IN TAXPAYER SERVICE'S TOLL-FREE TELEPHONE WORKLOAD AWAY FROM THE NON-TECHNICAL, MORE ROUTINE INQUIRIES TO MORE COMPLEX TAX LAW AND ACCOUNT RELATED INQUIRIES.

THERE ARE TWO OTHER INITIATIVES IRS HAS UNDERTAKEN THAT, WHEN FULLY IMPLEMENTED, WILL CONTRIBUTE TO THE QUALITY OF SERVICE PROVIDED TO TAXPAYERS. WE HAVE INITIATED A NEW, MORE SOPHISTICATED SYSTEM FOR MEASURING THE ACCURACY OF OUR RESPONSES TO TAXPAYERS' QUESTIONS. WE WORKED WITH GAO TO DEVELOP THE INTEGRATED TEST CALL SURVEY SYSTEM, WHICH BECAME OPERATIONAL IN JANUARY OF 1988. THE SYSTEM PERMITS A STAFF OF SPECIALLY TRAINED PERSONNEL LOCATED IN OUR NATIONAL OFFICE HERE IN WASHINGTON TO PLACE TEST CALLS TO OUR ANSWERING SITES THROUGHOUT THE COUNTRY, AND TO ASSESS THE COURTESY, COMPLETENESS AND ACCURACY OF THE RESPONSES TO TAXPAYER INQUIRIES. ABOUT 20,000 CALLS WERE PLACED DURING THE 1988 FILING SEASON, AND WE EXPECT TO MAKE ABOUT THE SAME NUMBER THIS FILING SEASON.

WE BELIEVE THAT THIS SYSTEM WILL ASSIST US IN IMPROVING THE QUALITY OF SERVICE WE GIVE TAXPAYERS. THIS YEAR, WE ARE ASKING A TOTAL OF 62 QUESTIONS COVERING 32 TAX LAW CATEGORIES. CALLS WILL BE MADE TO ALL 31 TOLL-FREE CALL SITES AROUND THE COUNTRY. THE SYSTEM IS DESIGNED TO PERMIT US TO GAUGE THE

ACCURACY AND COMPLETENESS OF ANSWERS BY CALL SITE, BY REGION AND FOR THE ENTIRE COUNTRY. IN ADDITION, WE CAN MEASURE THE ACCURACY OF OUR ANSWERS BY TAX LAW CATEGORY.

THE SYSTEM ALSO ALLOWS US TO IDENTIFY THOSE AREAS OF TAX LAW THAT NEED TO BE EMPHASIZED IN TRAINING, AS WELL AS THOSE OFFICES THAT NEED PARTICULAR ASSISTANCE. IT ALSO PROVIDES INFORMATION ON TRENDS IN OUR TECHNICAL RESPONSES. A NEW FEATURE ADDED THIS YEAR TO HELP US CORRECT PROBLEM AREAS AS THEY ARE IDENTIFIED IS OUR REGIONAL DIAGNOSTIC CENTERS. BASED ON WEEKLY DATA PROVIDED BY THE NATIONAL OFFICE TEST CALL SITE, THESE REGIONAL CENTERS WILL ALSO MAKE TEST CALLS. UNLIKE THE TEST CALL SYSTEM IN THE NATIONAL OFFICE WHICH CANNOT REVEAL ITS QUESTIONS, THE DIAGNOSTIC CENTERS CAN PROVIDE SPECIFIC DETAILS ABOUT INCORRECT CALLS TO THE LOCAL OFFICES, ADVISING THEM OF TAX LAW CATEGORIES THAT NEED IMPROVEMENT.

ANOTHER TAXPAYER SERVICE INITIATIVE IS USING AUTOMATION TO HELP OUR TAXPAYER ASSISTORS. CURRENTLY, ASSISTORS MUST USE A VARIETY OF WRITTEN DOCUMENTS SUCH AS IRS PUBLICATIONS, THE INTERNAL REVENUE CODE, REVENUE RULINGS, ETC. TO ANSWER TAXPAYERS' TAX LAW INQUIRIES. THE QUALITY AND ACCURACY OF THEIR ANSWERS OFTEN DEPENDS ON THE MATERIAL THEY HAVE ACCESS TO AND HOW WELL THEY ARE ABLE TO RESEARCH THAT MATERIAL. THIS PROJECT IS DESIGNED TO AUTOMATE REFERENCE MATERIAL FOR USE BY TAXPAYER ASSISTORS.

OTHER TIME-SAVING FEATURES THAT SHOULD IMPROVE OUR RESPONSIVENESS TO TAXPAYERS INCLUDE THE CAPABILITY OF ELECTRONICALLY ORDERING FORMS AND PUBLICATIONS FROM A CENTRALIZED ORDERING SITE FOR TAXPAYERS. THIS WILL SAVE SEVERAL DAYS OVER THE CURRENT METHOD OF MAILING A REQUEST TO THE CENTRALIZED ORDERING SITE. THE SYSTEM WILL ALSO PROVIDE ASSISTORS WITH MORE INFORMATION TO DEAL WITH ACCOUNT-RELATED INQUIRIES THAN THEY HAVE NOW.

THE AUTOMATED TAXPAYER SERVICE SYSTEM PROJECT IS BEING TESTED IN OUR DALLAS DISTRICT CALL SITE. WE HAVE 40 WORKSTATIONS IN OPERATION THIS FILING SEASON AT THAT LOCATION.

AND WE HOPE TO FULLY AUTOMATE THE ENTIRE CALL SITE NEXT YEAR. BASED ON OUR EVALUATION OF THE DALLAS PROJECT, WE WILL DECIDE WHETHER TO MOVE TOWARDS NATIONWIDE IMPLEMENTATION.

IN SUMMARY, THE PAST SEVERAL YEARS HAVE SEEN A NUMBER OF INITIATIVES IN THE TAXPAYER SERVICE AREA. WE KNOW THAT THERE IS A LOT OF WORK YET TO BE DONE. BUT WE ARE MOVING IN THE RIGHT DIRECTION AND ARE ALREADY SEEING IMPROVEMENTS.

PROBLEM RESOLUTION PROGRAM

I WOULD LIKE TO DISCUSS A NUMBER OF IMPROVEMENTS IN OUR PROBLEM RESOLUTION PROGRAM (PRP) WHICH AS YOU KNOW HELPS ENSURE FAIR AND EQUITABLE TREATMENT OF TAXPAYERS ACROSS THE COUNTRY. THE MAJOR FINDING IN A 1987 GAO REPORT IN THIS AREA WAS THAT THE PROBLEM RESOLUTION PROGRAM HAS BEEN SUCCESSFUL IN ACHIEVING ITS TAXPAYER ASSISTANCE OBJECTIVES AND HELPING TO IMPROVE IRS' IMAGE IN THE EYES OF TAXPAYERS. GAO FOUND THAT TAXPAYERS WERE GENERALLY SATISFIED WITH THE ASSISTANCE THEY RECEIVED FROM THIS PROGRAM.

MANY CHANGES HAVE BEEN MADE IN IRS' OPERATIONS, INCLUDING THE PROBLEM RESOLUTION PROGRAM, SINCE THE PERIOD COVERED BY THE REVIEW. WE BELIEVE THAT THE SUCCESSFUL 1986, 1987 AND 1988 FILING PERIODS HAVE DEMONSTRATED THE MAJOR IMPROVEMENTS MADE THROUGHOUT THE SERVICE, AND THE CURRENT DECLINE IN THE NUMBER OF TAXPAYERS NEEDING PRP ASSISTANCE BEARS THAT OUT.

AS YOU WELL KNOW, THE OMNIBUS TAXPAYER BILL OF RIGHTS CODIFIED THE PROCEDURES THAT WE HAD INSTITUTED IN FEBRUARY 1988 TO GIVE PROBLEM RESOLUTION OFFICERS INCREASED AUTHORITY TO INTERCEDE ON BEHALF OF TAXPAYERS. TAXPAYER ASSISTANCE ORDERS CAN BE ISSUED TO PREVENT IRS ACTION OR INACTION THAT WOULD CAUSE HARDSHIP FOR TAXPAYERS. THE TAXPAYER OMBUDSMAN OR THE OMBUDSMAN'S DESIGNEE HAS THE AUTHORITY TO ISSUE THESE TAXPAYER ASSISTANCE ORDERS. THE NEWLY-DEVELOPED FORM 911, APPLICATION FOR TAXPAYER ASSISTANCE ORDER TO RELIEVE HARDSHIP, CAN BE USED BY TAXPAYERS TO APPLY FOR A HARDSHIP RELIEF. COPIES OF THIS FORM WERE DISTRIBUTED TO ALL MEMBERS OF CONGRESS WITH A LETTER FROM THE TAXPAYER OMBUDSMAN IN JANUARY.

THE AUTHORITY OF PROBLEM RESOLUTION OFFICERS HAS BEEN ENHANCED IN OTHER AREAS ADMINISTRATIVELY, SO THEY CAN APPROVE REPLACEMENT CHECKS FOR LOST OR STOLEN REFUNDS, SUBSTANTIATE CREDITS TO TAXPAYER ACCOUNTS, AND ABATE CERTAIN PENALTIES FOR REASONABLE CAUSE.

A FINAL, VERY IMPORTANT EXAMPLE OF THE ADVOCACY OF THE TAXPAYER OMBUDSMAN IS THE KEY ROLE OF THE OMBUDSMAN IN THE PROCESS OF IMPLEMENTING THE OMNIBUS TAXPAYER BILL OF RIGHTS. THE TAXPAYER OMBUDSMAN HAS BEEN AN INTEGRAL PART OF IMPLEMENTATION PLANNING, AND HAS REVIEWED PLANNED IRS ACTIONS FOR CONSISTENCY WITH THE SPIRIT AS WELL AS THE LETTER OF THE TAXPAYER BILL OF RIGHTS.

TAX SYSTEM REDESIGN

AT THIS POINT, I WOULD LIKE TO SWITCH FROM TALKING ABOUT OUR PRESENT PROGRAMS TO ADDRESS THE FUTURE. SPECIFICALLY, I'D LIKE TO DISCUSS WITH YOU OUR PLANS FOR REDESIGNING OUR TAX INFORMATION SYSTEMS FOR THE 1990'S.

THE GOAL OF OUR TAX SYSTEM REDESIGN EFFORTS IS TO REMOVE THE BARRIERS TO QUALITY AND SERVICE IN THE CURRENT SYSTEM AND TO ENABLE IRS TO BETTER MEET ITS OBLIGATIONS TO THE PUBLIC. RIGHT NOW, BECAUSE OUR MAJOR TAX INFORMATION SYSTEMS ARE ANTIQUATED, WE CAN'T PROVIDE THE LEVEL OR QUALITY OF SERVICE THAT WE WANT TO PROVIDE.

OUR NEW SYSTEMS WILL CHANGE HOW WE DO BUSINESS FOR THE BETTER IN THE FOLLOWING WAYS:

-- WITH CURRENT SYSTEMS, MANY TAXPAYERS CALL WITH AN ACCOUNT PROBLEM, ONLY TO BE TOLD THAT THE INFORMATION NECESSARY TO RESOLVE THEIR CASE IS NOT AVAILABLE. IN THE REDESIGNED SYSTEM, IRS WILL BE ABLE TO HELP TAXPAYERS AT THE FIRST POINT OF CONTACT, SIGNIFICANTLY REDUCING THE TAXPAYER BURDEN IMPOSED BY THE CURRENT SYSTEM.

-- IN OUR PRESENT PAPER INTENSIVE SYSTEMS, IT NORMALLY TAKES A MINIMUM OF TWO AND OFTEN UP TO SIX WEEKS FOR AN

EMPLOYEE TO OBTAIN A COPY OF AN ORIGINAL TAX RETURN. TO SPEED RESOLUTION, TAXPAYERS NOW ARE SOMETIMES ASKED TO PROVIDE ANOTHER COPY OF THE TAX RETURN THAT WE ALREADY HAVE. IN THE REDESIGNED SYSTEM, ELECTONICALLY-STORED TAX RETURN INFORMATION WILL BE AVAILABLE IMMEDIATELY.

-- THE PROCESSING OF TAX RETURNS UNDER OUR CURRENT SYSTEMS IS MANUALLY INTENSIVE AND ERROR PRONE. IN THE REDESIGNED SYSTEM, ON-LINE VALIDATION AND THE AUTOMATION OF MANY MANUAL PROCESSES IN HANDLING THESE RETURNS WILL RESULT IN A SYSTEM LESS SUSCEPTIBLE TO ERROR, PROVIDING A BETTER QUALITY AND MORE TIMELY PRODUCT TO THE TAXPAYER.

AS YOU CAN SEE, OUR FOCUS IS ON SOLVING THE PROBLEMS OF THE CURRENT SYSTEMS, SO THAT WE CAN KEEP ERRONEOUS INFORMATION OUT OF THE SYSTEM AND BE MORE RESPONSIVE TO BOTH OUR OWN EMPLOYEES AND TAXPAYERS. WE BELIEVE WE WILL BE ABLE TO DO THIS BY TAKING ADVANTAGE OF THE TECHNOLOGY THAT IS AVAILABLE TODAY.

I AM PLEASED WITH THE PROGRESS WE HAVE MADE IN OUR SYSTEMS DEVELOPMENT EFFORT TO DATE. IN CONJUNCTION WITH OMB AND THE DEPARTMENT OF THE TREASURY, WE HAVE COMPLETED A COMPREHENSIVE MANAGEMENT PLAN THAT DESCRIBES A VISION OF WHAT WE WOULD LIKE OUR SYSTEM TO LOOK LIKE IN THE 1990'S. THE PLAN ALSO DESCRIBES THE PROCESS THAT WILL ALLOW US TO ACHIEVE OUR VISION. THE PROCESS IS WELL UNDERWAY, AND WE HAVE COMPLETED A DESIGN CONCEPT WHICH ALLOWS US TO PHASE IN THE REDESIGNED SYSTEM IN A WAY THAT MINIMIZES DISRUPTION AND RISK.

I BELIEVE IT IS IMPORTANT TO UNDERSTAND THAT OUR REDESIGN EFFORT IS ABOUT MORE THAN SIMPLY REPLACING AN ANTIQUATED TAX ADMINISTRATION SYSTEM THAT IS BEGINNING TO GROAN UNDER THE WEIGHT OF DEMANDS IT WAS NOT DESIGNED TO MEET. IN REDESIGNING OUR SYSTEMS, WE ARE TAKING A HARD LOOK AT EVERYTHING WE DO AND ARE ASKING OURSELVES HOW TO USE TECHNOLOGY TO PROVIDE MORE TIMELY AND BETTER QUALITY SERVICE. THE INTERNAL REVENUE SERVICE IS COMMITTED TO PROVIDING AN IMPROVED LEVEL OF SERVICE THROUGH A COORDINATED SYSTEMS PLANNING AND DEVELOPMENT PROCESS THAT EMBRACES INFORMATION TECHNOLOGY.

THE NEED FOR CONGRESSIONAL HELP

In this regard, Mr. Chairman, I would ask for the Subcommittee's assistance. First, we need your assistance in obtaining the necessary budget resources beginning with our FY1990 budget submission. We can't do what we want to do without the budget resources we need.

Second, we need your assistance in obtaining and retaining the human resources we need for the 1990's. Specifically, like many other Federal agencies, we are facing a formidible gap between what we can offer top notch prospects and experienced personnel and what the private sector can offer. While we do not expect to match private sector wages, we must be competitive and right now in many places we are not competitive. This creates a disincentive for the best people coming out of college to work at IRS. Likewise, our top staff and managers---as well as our senior agents and others with technical skills---face the choice of staying with the IRS at lower wages or leaving for more lucrative private sector jobs.

Third, as I have repeatedly testified, I urge the Congress to minimize legislation that impacts on IRS and on taxpayers and their advisors. There is a growing public awareness that legislative changes in the tax area are increasing in magnitude and velocity. Over the last 25 years, passage of a major tax law has become an annual tradition. In the last 13 years, 138 public laws have been enacted which changed the Internal Revenue Code -- an average of 10 1/2 times each year. Legislative change is occurring too rapidly for <u>any</u> of us to absorb. We are seeing higher levels of anxiety born of frustration that comes from an inability to cope with this much change in our tax laws. I urge Congress to let us all catch our breath.

CONCLUSION

As you know, several weeks ago I announced that for personal reasons I would be leaving the Internal Revenue Service to return to the private practice of law in early March. This was a very difficult decision for me to make, and leaving the Internal Revenue Service will not be easy. I enjoyed my tenure at IRS and believe that we accomplished a number of worthwhile things.

It has been a privilege and a pleasure to serve as the Commissioner of Internal Revenue -- to be able to work with the dedicated and capable individuals at the Internal Revenue Service and throughout the Administration, Congress, and the taxpayer and practitioner communities to provide quality customer service to the public. In particular, Mr. Chairman, I am pleased to have had the honor to work with you and the Members of your Subcommittee and your fine staff on improving the administration of our Nation's tax laws. Although we may have differed on issues over the years, we share the common goal of ensuring that the system of tax administration in this country is the very best and fairest it can be. I salute you for your leadership in this area.

Like yourself, Secretary Brady recognizes that the importance of an effective tax administration system cannot be underestimated. My successor will undoubtedly be someone who is dedicated to these same goals and someone who cares deeply about fair and efficient tax administration.

Although I am leaving the Internal Revenue Service, there are people and policies in place to continue the tradition of quality and excellence that are the hallmarks of our organization.

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON D C 20224

COMMISSIONER

FEB 22 1988

All Employees:

I know all of you have heard about the Omnibus Taxpayer Bill of Rights, which Congress passed this last November. Because this new law will affect the way you do your job and the way our customers -- American taxpayers -- view us, I want you to know what the law says.

You may remember that some of the provisions in early versions of this law were written in a way that caused us concern. However, we have always strongly endorsed the need for taxpayers to know what their rights are and for IRS employees to protect taxpayers' rights. I am satisfied that, as revised, the law strikes a proper balance between taxpayers' rights and responsibilities. Moreover, it complements our emphasis on improving quality and customer service.

Several current IRS administrative practices have been made into law by the Omnibus Taxpayer Bill of Rights. One example is Publication 1, Your Rights As A Taxpayer, which we made available to taxpayers in November. Another is the development of procedures for the Taxpayer Ombudsman and field Problem Resolution Officers to issue Taxpayer Assistance Orders to help taxpayers with problems with the IRS.

Throughout the implementation planning process, care has been taken to make sure that our actions agree with the spirit, as well as the letter, of the law. I know that I can count on each of you to maintain this commitment as you put our plans into effect.

So that you will know what this new law provides, I have enclosed a summary of its key provisions. You will be receiving more information in a video tape and in training from your function.

With best regards,

Sincerely,

Lawrence B. Gibbs

Enclosure

THE OMNIBUS TAXPAYER BILL OF RIGHTS
A SUMMARY OF KEY PROVISIONS

- The IRS must continue its current practice of informing taxpayers of their rights and IRS obligations. This is being accomplished by the distribution of IRS Publication 1, Your Rights As A Taxpayer. The new law requires the IRS to give copies of this publication to all taxpayers contacted about the amount of tax they owe or the collection of taxes owed. The IRS will also give copies of this publication to taxpayers to advise them of their rights at or before certain in-person interviews.

- Under the new law, taxpayers may continue to make audio recordings of certain in-person interviews. Also, taxpayers may not be required to accompany their authorized representatives to interviews without an administrative summons.

- The law continues the IRS practice of allowing taxpayers to suspend an interview to consult with an authorized representative.

- Under the new law, the IRS must abate penalties or additions to tax caused by written advice given by the IRS that is wrong. This expands current IRS administrative practice.

- The Taxpayer Ombudsman and Problem Resolution Officers may issue Taxpayer Assistance Orders to stop or change IRS actions that cause significant hardship to taxpayers. Under the new law, representatives as well as taxpayers may apply for these. New IRS Form 911 is the form taxpayers should use when applying for a Taxpayer Assistance Order.

- Current IRS Policy Statement P-1-20 provides that tax enforcement results may not be used to evaluate IRS enforcement officers, appeals officers or reviewers. While this Statement remains in effect, the new law provides that the IRS may not use tax enforcement results, such as amounts of tax dollars collected, to evaluate Collection enforcement employees.

- The IRS current administrative practice of considering installment payment agreements for taxes owed is now authorized by the new law. The only change is that the IRS must now give taxpayers 30 days notice before changing or revoking an installment agreement in certain situations.

- The new law requires the IRS to rewrite some of its notices to make them more easily understood by taxpayers. Specifically, tax due and deficiency notices must at least describe the basis for and amounts of tax, interest and penalties. These notices are being reviewed and revised.

- An IRS Assistant Commissioner for Taxpayer Services must be established under the new law. The offices that will be under this new Assistant Commissioner will be announced by May 9, 1989.

- The period during which a levy may not be made following notice of intent to levy is extended by the law from 10 to 30 days. Certain exemptions from levy are increased and District Directors must now approve the seizure of a personal residence. Also, banks must hold levied accounts for 21 days after notice of levy is served to allow a taxpayer to prove the levy is improper.

- The new law requires the IRS to provide a procedure for taxpayers to administratively appeal liens made by the IRS. This procedure will be administered by Collection's Special Procedures function.

- Current law allows a court to require the government to pay a taxpayer's costs and attorney fees when the IRS' position in court was not substantially justified. The new law provides that awards of costs and fees to taxpayers now include administrative, as well as court, proceedings.

- The new law permits taxpayers to sue the IRS for not releasing a Federal tax lien within 30 days or if they are harmed by unauthorized actions. IRS employees are not personally liable under the new law.

STATEMENT OF SENATOR DAVID PRYOR

CHAIRMAN OF THE FINANCE SUBCOMMITTEE ON PRIVATE

RETIREMENT PLANS AND OVERSIGHT OF THE INTERNAL REVENUE SERVICE

I would like to welcome Commissioner Larry Gibbs to his last hearing before Congress as Commissioner of Revenue. It is hard to believe that it has been over two years since you first appeared before this subcommittee. We have not always been on the same side of the issues, but we have always been committed to the same goal -- the betterment of the Internal Revenue Service.

A number of times, you have asked me to speak to Internal Revenue Service employees from around the country. I was always struck by one fact. Whenever I spoke the name of Larry Gibbs, those employees cheered. Mr. Commissioner, your employees cheered because you have restored their pride in working for an essential agency of the Government. I believe that is the greatest tribute to your work as Commissioner. As you once again become a private citizen, I hope we can continue to work together to improve the Internal Revenue Service.

Today, we are here to discuss the Internal Revenue Service's commitment to quality. The General Accounting Office's report, Managing IRS: Actions Needed to Assure Quality Service in the Future, paints a bleak picture -- the picture of a train wreck.

Sometime in the mid-1990s, the present computer system will no longer be able to handle its workload. The GAO report, however, tells us that the IRS is not taking the necessary steps to prevent the system from crashing. The report shows that progress has been slow due to the lack of effective management direction and commitment, weakness of IRS planning, and technology procurement problems. Consequently, the time frame for full implementation of a new system that will be able to handle the present workload has slipped from 1995 to 1998. Since

1982, the IRS has pursued four different developmental approaches for the proposed modernization project. Despite five years of work at a cost of over $70 million, the GAO believes that the IRS is essentially still at square one. Failure to prepare for the crunch that is coming in the mid 1990s will result in a disaster hundreds of times worse than the Philadelphia episode of 1985.

The modernization program will require a large investment of public funds -- as much as $11 billion according to the IRS's own business plan. The GAO report suggests that the IRS's ability to manage these funds is questionable. The report states, "IRS's ability to satisfy its financial responsibilities and meet taxpayer expectations has been undermined by accounting processes with weak internal controls and old systems that produce inaccurate and untimely information." In other words, the agency that requires each of us to keep perfect records on our finances, cannot keep track of its own finances.

For example, the GAO report cites the acquisition and implementation of the Realtime Input System or "RIS". When the IRS cancelled this project in March of 1986, its implementation schedule had slipped 18 months and its cost estimate had grown 14 times from the original $8.5 million estimate to around $120 million. The IRS could not give the GAO the actual amount spent on the project before its cancellation because the IRS did not even have a system in place to keep track of the project's cost. After spending millions of dollars, the IRS itself admitted it had never established the system's "feasibility, desirability, and cost effectiveness."

In another example, an internal audit report found that the IRS purchased 2,000 more computer terminals than the IRS itself admitted it needed. On top of this, IRS Computer Services had requested funds for an additional 5,000 terminals. Total cost of these unneeded terminals: $25 million. To get an idea of the

magnitude of this purchase, the internal audit report states that "this quantity would cover the replacement of all old terminals plus a 72 percent network expansion." And, despite terminal utilization studies which showed that 7,000 terminals were not needed, IRS Computer Services ordered the terminals anyway. The report concludes that weaknesses in the IRS's accounting system increases the potential for employee fraud.

The IRS management review study raises serious doubt about the IRS's ability to manage the large amount of appropriated funds needed to implement a far-reaching computer modernization.

In addition to these problems, I would like the subcommittee to discuss various long-term problems with the IRS's handling of taxpayer correspondence and its managing of the Problem Resolution Program. Over the years, a number of reports, both within and without the IRS, have pointed out problems with the IRS's handling of taxpayer correspondence at its Service Centers. A GAO report issued last year reveals that out of 12 million taxpayer correspondence cases closed in fiscal year 1987, the IRS had made critical errors in over 31 percent of these cases.

To understand the significance of this finding, it is important to picture what is actually occurring here. In many cases, somewhere in the bowels of the IRS Service Center bureaucracy someone, or some computer, has turned on the deficiency notice machine. It means that somewhere a taxpayer has responded to the notice as required. But despite the taxpayer's response, 31 percent of the time IRS personnel fail to "turn off" the machine. The taxpayer's letter or call simply vanishes into a bureaucratic black hole. The result is that the IRS issues additional erroneous notices and possibly even initiates wrongful collection actions. This problem certainly diminishes taxpayer relations, increases taxpayer frustration, and increases the IRS's workload. Many of the taxpayer horror

stories brought out during the discussion of the Taxpayers' Bill of Rights can be traced directly to this correspondence problem.

Mr. Commissioner, I would like to tell you about a recent early morning trip that I made to see the Washington operations of Federal Express. As the daily packages arrived for delivery, Federal Express employees checked each one in their central computer system to insure proper delivery. At any time, a customer of Federal Express can call a number to check on the location of his or her package. Within a half an hour, a Federal Express employee will call the customer back and tell him or her the exact location of the package -- whether it is on a plane or truck and whether it is scheduled to arrive on time. I asked one of the employees what happens if they ever lose a package. The employee became very grave and said, "the person last responsible for the package receives a call from the president of the company. They have a little talk about that lost package. And that is usually the last time a package is ever lost on that employee's watch."

Mr. Commissioner, I want you to tell the subcommittee why we cannot have that sort of accountability and eye for quality at the IRS. The question before us today is what sort of IRS will we have by the end of the 1990s -- a Federal Express or Studebaker. No less than the solvency of the U.S. Government is at stake.

The subcommittee today will concentrate on five subject areas: 1. Computer systems modernization; 2. Problems with IRS financial accounting systems; 3. Taxpayer correspondence problems at the Service Centers; 4. The "quality" of the quality service initiatives at the IRS; and 5. "Problems" with the Problems Resolution Program.

SERVICE

HOW TO HANDLE CUSTOMERS' GRIPES

Complainers can shoot down a company faster than you can say "I'm sorry." But GE, Coca-Cola, Johnson & Johnson, and others are turning them into loyal buyers. ■ *by Patricia Sellers*

FRED JEROME survived a frequent flier's nightmare. Boarding a 9:30 Pan Am shuttle in New York one morning, he expected to arrive in Boston in plenty of time for a full afternoon of business meetings. However, Logan Airport was blanketed in fog and the pilot circled for two hours before landing in Hartford, Connecticut, to refuel.

"No one will be permitted to leave the plane," the pilot announced, frustrating passengers who wished to switch to a rental car or use a telephone. When the pilot said he was returning to LaGuardia, some rose in fury, yelling, "You can't do that! I've got get to Boston!" He relented and finally landed in Boston about 4 P.M. Jerome caught a flight home and arrived in New York at 6:30 P.M. His day was shot and he was steamed.

What should a company do for angry customers? According to those who have tackled the issue: just about anything it can. Studies show customers tell twice as many people about bad experiences as good ones, so complainers left unhappy can send a company's image crashing. Simply listening to complaints tremendously boosts brand loyalty—that is, a customer's tendency to buy again (see chart). "The key is getting customers to complain to the company," says John Goodman, president of Technical Assistance Research Programs, a Washington, D.C., consulting firm that has been studying corporate complainers for the past decade.

The firm used buying patterns, profit margins, and dozens of other factors to develop an economic model that calculates the return on company dollars invested in units that handle complaints and inquiries. The average return for makers of consumer durables like washing machines and refrigerators is 100%. In other words, if manufacturers spend $1 million, they get $2 million in benefits. For banks it is as much as 170%. The payoff can be even higher in retailing, where top-quality service is essential for

British Airways finds that Americans use its new video complaint booths at Gatwick more than Britons do. It may put them in New York.

the plane in the airline's new Video Point booths. Customer service managers view the videos and respond to complaints.

In August, British Airways gave full refunds averaging $3,200 to 63 passengers on a Concorde flight from London, because a technical problem left customers bound for Miami and Washington grounded in New York. After passing out letters of apology, the airline chartered planes to fly the passengers to their destinations. "We'd rather spend money and keep customers satisfied than initiate five or six complaints," says John Lewis, vice president of customer services. That philosophy pays off. In the fiscal year that ended March 31, British Airways posted one of the largest net incomes of all international airlines, $189 million on revenues of $7 billion. Six years ago it was one of the biggest money losers in the skies.

Just listening to grievances can keep buyers from walking. The figures above are for shoppers who are dissatisfied with products or services worth more than $100.

Companies that want to win over dissatisfied customers must empathize with them and reward them. "Turning away a complainer by telling him, 'It's our policy,' enrages him," says Richard C. Whiteley, president of Forum Corp., a Boston consulting firm that specializes in customer service. "That's the corporate equivalent to your parents saying, 'Because I said so.'" Hechinger Co., a Maryland-based retailer of hardware and home and garden gear, accepts returns of items even when the customer has obviously abused them. The retailer sends particularly perturbed purchasers a dozen roses. Hechinger posted profits of $41.9 million on sales of $742.2 million last year. Earnings have compounded 29% annually since the company went public 16 years ago.

Neiman Marcus, the Dallas-based specialty retailer, is gracious with gripers too. "We're not just looking for today's sale. We want a long-term relationship with our customers," says Gwen Baum, director of customer satisfaction for the 22-store chain. "If that means taking back a piece of Baccarat crystal that isn't from one of our stores, we'll do it." For most retailers, dishonest customers who return items that they have already used or bought elsewhere account for fewer than 5% of returns. Says Baum: "If you let profit protection or security rule the way you treat customers, satisfaction is bound to suffer."

Customers seem to give companies bonus points if top managers hear them out. Rex McClelland, senior vice president of operations at Delta Air Lines, regularly calls passengers who write to complain. Marriott Chairman J. W. Marriott Jr. reads about 10% of the 8,000 letters and 2% of the 750,000 guest comment cards the company receives each year. When Marriott was president in the late 1960s, some 30,000 hotel guests submitted comment cards each year. He read every one.

AT FIDELITY BANK, a 124-branch institution based in Philadelphia, President Rosemarie B. Greco, a former nun, is devoted to complaint handling. Results have been close to miraculous. When Greco, who joined the bank as a secretary 20 years ago, became president in early 1987, letters from customers poured into her office. "Maybe because I'm a woman they thought I would be more sensitive to their needs," she says. Greco phoned one retired customer who had serious problems with his IRA account statement. "He was beside himself with gratitude," she says. "That taught me an important lesson about letting customers know management is personally involved with their problems."

Fidelity assigned 25 people to visit American Express, L.L. Bean, and ten other companies known for excellent customer service. "We didn't look at any banks. Service is service," says Greco, 42. Fidelity consolidated its complaint-handling systems—one for each of 14 different business segments. Customers with problems involving savings accounts, auto loans, and credit cards now call one telephone number. Clients with major problems write to the office of the president. Greco reads all of those letters, as well as summaries of the bank's other complaints and inquiries, which total around 120 monthly. Today 87% of Fidelity's customers say they are satisfied or highly satisfied with service, vs. 57% in 1986.

Loyalty is especially important to firms that depend on customers to buy again and again. Many companies find the answer in toll-free 800 numbers. When Whirlpool pioneered the service in 1967, "Ralph Nader was attacking big business for not listening to customers," says Gary L. Lockwood, group director for consumer services. "We wanted to show that we listen." At first, 800 numbers were considered a gimmick, but today over half of all companies with more than $10 million in sales use them to handle complaints, inquiries, and orders, according to the American Management Association. AT&T and its rivals rang up around $4.5 billion in revenues last year from more than eight billion 800-number calls.

THE AIRLINES THEY LOVE TO HATE

COMPLAINTS per [illegible] passengers	
Continental*	16.9
Eastern*	13.3
Northwest	9.1
Pan Am	9.0
TWA	8.2

Passengers on Aloha Airlines, Air Wisconsin, and Southwest Airlines registered the fewest complaints with the federal government in the first half of 1988.

Coca-Cola installed its 1-800-GET-COKE lines in late 1983 to promote feedback. Roger Nunley, manager of industry and consumer affairs at Coca-Cola USA, says some studies indicated that only one unhappy person in 50 takes time to complain. "The other 49 switch brands, so it just makes good business sense to seek them out," he says. Without the toll-free lines, Coca-Cola might never have understood the depths of its error in trying to replace old Coke with new.

Right after the company launched its reformulated New Coke in 1985, calls on the phone system fizzed from an average of 400

a day to more than 12,000. Nine out of ten were from customers who said they preferred the old cola to the new drink. On the day following old Coke's return as Coca-Cola Classic, 18,000 people called, including thousands who had complained earlier. They wanted to say thank you. Nunley says that consumer "emotion"—his term for brand loyalty—is stronger today for Coke Classic than it was before the episode. And by selling both Cokes and several new colas, the company has increased its U.S. market share to over 40%.

Toll-free phone systems deliver additional benefits. A Technical Assistance Research survey for Coca-Cola showed that a complainer who is denied a request over the phone is 30% more likely to remain brand loyal than a buyer who receives the same message in a letter. That's because a phone conversation is more personal and gives the service representative a chance to explain the company's position and woo the customer back. Not only is answering complaints by phone faster, it usually saves money. American Express spends five to ten times as much replying to a letter as it does answering a complaint over its toll-free lines. The company often ends up having to call the letter writer anyway to get more information about the problem.

GE's service reps have fielded some bizarre calls: One homeowner wanted to convert a black-and-white TV to color.

Companies must carefully train, monitor, and motivate the folks who field the 800-number calls. At Procter & Gamble, new customer service representatives spend four to five weeks in classrooms learning to diffuse anger as well as to solve problems. Toyota, which touts customer courtesy in its ads, ranks its telephone representatives daily on productivity. American Express used to track only the number of calls each operator handled. Now it evaluates the way they talk to customers too. To show the importance it puts on telephone reps at its customer support center in Colorado Springs, Digital Equipment places them next to windows, where they can peer at Pike's Peak. Managers sit in windowless offices.

The GE answer center in Louisville is the state-of-the-art 800-number operation, according to many customer service experts. Manager N. Powell Taylor developed some of his ideas by visiting Disney University in Florida, which trains employees for Disney World. "Disney has a great reputation for knowing how to make people happy," he says. At Disney, Taylor learned the importance of professional dress (GE male reps wear coats and ties, and women wear dresses and suits), corny motivators (computer screens carry greetings such as "Put a smile in your voice"), and incentives (GE awards clothing, sporting goods—and trips to Disney World). Taylor and his staff evaluate the service representatives three times a year. If they earn a score of 80%—based on productivity, attitude, attendance, and quality of service—the new goal becomes 85%. Many top reps move to field offices as sales managers.

The five-year-old GE answer center handles three million calls a year and costs more than $8 million to operate. A giant database, which stores 750,000 answers concerning 8,500 models in 120 product lines, "makes every representative an expert," says Taylor. Service reps have fielded some bizarre calls. A submarine off the Connecticut coast needed help fixing a motor, a homeowner wanted to convert a black-and-white TV to color, and technicians on a James Bond film couldn't get underwater lights to work. GE says its people can solve 90% of complaints or inquiries on the first call.

THIS YEAR the answer center will direct some 700,000 callers to GE dealers, 10,000 of which are logged in the center's computers. Surveys indicate that 95% of callers are satisfied with the answer center's service, and complainers often convert into even more loyal buyers. The center produces at least twice the return GE expected. The company probably spends between $2.50 and $4.50 on a typical call—15% are complaints—and reaps two to three times that in additional sales and warranty savings. Says Taylor: "Most businesses don't understand that customer service is really selling."

Good complaint handling at GE, Whirlpool, and other companies has brought the appliance industry a long way. Twenty years ago it was among the worst in responding to complainers. Today, according to the Council of Better Business Bureaus, automakers and auto-services firms leave a lot of customers dissatisfied. But they're working hard to shape up. General Motors operates one of the most sophisticated toll-free systems, and Ford Motor is building an 800-number operation modeled on GE's. Auto dealerships are creating customer relations departments. And compared with five years ago, twice as many car dealers call customers following repairs to find out if everything's okay.

CUSTOMER NEEDS dictate what kind of service companies provide. Johnson & Johnson is consolidating seven 800-number systems into a single one, hoping to make its system more efficient. That means turning its 14 information specialists in areas like baby products and sun care into generalists. Over 14 months experts are giving them 300 hours of coaching on Band-Aids (Wound Management I), dressings and tape (Wound Management II), and 90 other products. J&J has raised the amount reps can refund without higher approval from nothing to $50.

The best—and cheapest—way to keep customers satisfied, of course, is to serve them well from the start. Dinah Nemeroff, director of customer affairs at Citicorp, says: "Our philosophy is that we never recover." Managers there must come up with a "hierarchy of horrors," a list of the five worst things they could do to customers and ways to avoid them. For example, a breakdown of an automatic teller machine is horrible because, as the company's ads once said, "The Citi never sleeps."

Advertising hype can create customer expectations that rise faster than service can improve. Consultant Whiteley of Forum Corp. warns companies not to overpromise because consumers rank reliability as the key ingredient of good service. Delta painted itself into a corner when it vowed, "Delta is ready when you are." So did Holiday Inn with its slogan: "No excuses. Guaranteed." These companies were begging for grumblers and eventually switched to less omnipotent slogans. Of course, the company that does live up to its promises can reap some very tangible benefits. With consumers smarter, choosier, and more demanding than ever before, courting the complainers has become an essential part of business. That it can also be good business is a nice bonus.

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March 13, 1989

Honorable David Pryor, Chairman
Senate Finance Subcommittee
United States Senate
205 Dirksen Building
Washington, DC 20510

Dear Senator Pryor:

As you are Chairman of the Senate Finance Subcommittee on Private Retirement Plans and Oversight of the Internal Revenue Service, I wanted to enter into the record hopefully my comments concerning not only the overseeing of the IRS but also to voice some serious concerns about what has happened since 1981 to the present date which I am convinced will cause major problems to individual families and to the Country as a whole, if they are not discussed and talked about. I will try to keep this as brief as possible but at the same time giving you details of my concerns.

As you can tell by the letter head, we have a financial planning firm in a suburb of St. Louis, Missouri. and have worked primarily with middle class and upper middle class families over a long period of time. Our services included trying to construct a balanced financial plan which included, in addition to normal investments, tax planning. Just to give you kind of a laundry list of what I see as grave concerns - in 1981, a tax bill was passed that encouraged all investors to invest in real estate, IRA's, capital gains areas such as stocks, mutual funds. It was, in my opinion, the most sweeping and favorable tax law ever passed, and the Americans responded and we pulled out of the Recession I feel because of their basic trust that the United States Government would never go back retroactively on an existing tax bill, that all changes would be made prospectively. The 1982 and 1984 tax acts addressed various changes, homed in on the definition of life insurance. that were still prospective. In the latter part of 1984, we had a major oil collapse which, in my opinion, was not addressed so basically we allowed the price of oil to be established by Middle East countries.

This obviously impacted the economy in a favorable manner with the exception of Oklahoma, Texas, Louisiana, and Colorado; those economies were devastated, and there were billions and billions of dollars lost by common normal people in oil income funds. I think something should have been done at that time frame to avoid the yo-yo effect of oil and gas.

The economy continued to prosper with the favorable tax legislation and now the artificially low oil prices. In 1986, a Tax Reform Act was passed that I think the Country will have great difficulty in getting over, which introduced for the first time retroactive provisions into our tax law. Those provisions were sweeping; investments encouraged by the 1981 tax act were not grandfathered; individual clients had legal obligations for possible future payments, expecting a particular tax benefit that was denied to them. There was an unfair increase in the alternative minimum tax by making most of the allowed deductions a preference item, which opened up the potential for people to pay taxes on a loss that had been reduced retroactively by the 1986 Act. Everyone in the United States who owned capital assets - stocks, bonds, real estate, etc. - were deprived of long-term capital gains tax treatment retroactively unless they sold those assets before December 31, 1986.

To give you a little insight - my brother-in-law invested many years ago in three duplexes as rental property; he has maintenanced those properties and for the most part has kept them rented consistently. With this tax law change on capital gains, even though the real estate appreciated, by the time he pays off the loan and pays taxes on the gain versus depreciation, he would barely clear enough money to simply pay the taxes; so he is locked in to going forward with the real estate and hopes that something will change. The Stock Market crash of October 19, 1987, has caused great concern amongst virtually everyone in the middle class to upper middle class area and a lack of confidence. I think that some underlying factors which could have caused this were the lack of trust caused by the 1986 Tax Reform Act. The 1988 tax correction act again, almost on a cavalier basis, went in and corrected areas on a retroactive basis without regard to the terrible consequences that that can cause. Additionally, they have added more preference items to the alternative minimum which could in some cases even jeopardize the tax credits on low-income housing investments that were included in the 1986 Tax Law.

I am convinced that most Americans who were in a position to try to save and invest for their future retirement have a complete lack of trust in the Federal Government that I have never seen in the past, which is primarily brought on by retroactive tax laws. I also see a fear that, again, I have not seen in all of my career. I know this is a broad sweeping scenario but I think the Government has basically limited itself to either raising or lowering interest rates to combat inflation or recession. The next recession that we go into, which I am afraid will happen in the not too distant future, will be very difficult to recover from since most past recessions were corrected by tax incentives that directed more money into the economy. I simply don't think any of those individuals will play in the future, and I am positive that the financial planning community will not recommend programs that are tax-oriented, simply because of what has happened. It appears to me that in addition to these tragedies, the IRS is going back on many investments using very strong tactics to try to disallow some of the deductions that were taken in previous years. I can state without any reservation this will cause many individual families across the United States to file for bankruptcy since they do not have the wherewithal to continue investments that they are legally obligated to that are producing less than the expected tax benefits which were promised in the 1981 tax law, and at the same time have tax audits done to General Partners who in most cases are very weak and will not really fight these attacks to the degree they would have during more prosperous times.

My major concern is that there will be a squeeze from all directions on investors who are already disillusioned, have lost their trust, and have great fear. This will eventually cause much more hardship and overall a reduction in revenue over the long-term. My major concern is that the IRS should not be used to aggressively go after investment vehicles mainly done in real estate that were done by the investors not only for the tax benefits but also for the long-term economic benefits that could possibly come by holding the real estate. Once again, it is a question of fairness and, under these unprecedented circumstances, a question of ruining families who went into investments that had all of the requirements necessary to pass the due diligence, namely, appraisals done by independent appraising firms, accounting opinions in most cases from Big-6 firms, and legal opinions on the tax areas at the highest level allowed by the American Bar Association. I am very concerned that if we continue to pounce on the individual taxpayers in our quest to balance the budget without raising taxes, we will throw the baby out with the bath water. I think there has to be a clear and on-going debate and study as to what all of these tax law changes have done to the economy and the confidence of the American citizens, along with a clear and concise policy as to how the IRS is used.

I sincerely appreciate your allowing me to voice these concerns.

Sincerely,

Roy M. Henry
President

RMH nh